UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 08-13555 (JMP)

- -x

In the Matter of:

LEHMAN BROTHERS HOLDINGS INC., et al.,

Debtors.

- -x

U.S. Bankruptcy Court

One Bowling Green

New York, New York

October 5, 2010

9:36 AM

B E F O R E:

HON. JAMES M. PECK

U.S. BANKRUPTCY JUDGE

CONTINUED EVIDENTIARY HEARING re Rule 60(b)

Transcribed By: Clara Rubin and Sharona Shapiro

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P R O C E E D I N G S

THE COURT: Be seated, please. Good morning.

UNIDENTIFIED SPEAKER: Good morning.

MS. BLOOMER: Good morning, Your Honor. Barclays' witness today is its expert witness on the issue of exchange-traded derivatives. We call Anthony Leitner to the stand.

THE COURT: Please raise your right hand, Mr. Leitner.

(Witness sworn)

THE COURT: Be seated, please.

MS. BLOOMER: For the record, Your Honor, Tricia Bloomer from Boies Schiller, for Barclays.

VOIR DIRE EXAMINATION

BY MS. BLOOMER:

Q. Good morning, Mr. Leitner.

A. Good morning.

Q. Could you please begin by giving an overview of your educational background?

A. I have a bachelor or arts degree from Columbia College, 1965. I spent a year reading economics at Trinity College in Cambridge, Cambridge University, and have a juris doctor from Northwestern University School of Law.

Q. And could you give an overview of your career after graduating law school?

A. I spent ten years in private practice at Curtis, Mallet-Prevost, Colt & Mosle here in New York. It was a corporate

practice; some litigation and international work. And in October of 1979, I joined the legal department of Goldman Sachs.

Q. And how long did you work for Goldman Sachs?

A. Until I retired in November 197 -- 19 -- 2003.

Q. And what have you done since then?

A. I've continued to stay active in the -- as a consultant in the equity regulatory and derivative regulatory sphere. I currently am consulting with NYSE Euronext, the stock exchange, on their market-structure issues and some of the new ventures that they have in the futures area and futures clearing area.

Q. Mr. Leitner, could you please move your microphone a little bit closer?

A. (Witness complies).

Q. Thank you.

Please describe generally your career at Goldman Sachs.

A. Well, I was the third lawyer hired at Goldman, and I was asked to basically take on regulatory counseling of all the new businesses that they were getting into at the time, one of which was the futures services business. And they were also increasingly involved in the fixed-income business. And over the course of the 1980s, I helped the fixed-income business develop their first over-the-counter derivative products, basically options on government securities, and continued to counsel the futures services area. I was also involved in

the -- as counsel initially to the J. Aron & Company, which was a commodities trading firm that we bought -- Goldman bought in 1980 or '81. And then over the course of time I became -- as the firm expanded its business in over-the-counter derivative swaps and things like that, and the legal department itself grew, we decided to combine the lawyers who were counseling the fixed-income area and the equities area and working on derivatives into a derivatives practice group, and I headed that group. And in 1999, I was asked to become general counsel of the equities division of the firm, which was the position I held when I retired. At that point, I was actually co-general counsel, because they'd asked some -- another colleague of mine to work with me for a while and get familiar and then ultimately take over that responsibility.

Q. Could you describe generally Goldman Sachs' derivatives business as you were involved in it?

A. There were several parts to it. First it was a futures commission merchant, an FCM, so it did brokerage business for firms. But it also had a clearing business. It was a clearing member of all of the U.S. and foreign exchanges, so it cleared transactions in futures products, both for clients and for itself.

The -- over time, Goldman expanded its business in -- as I said, in fixed-income securities, and also equity securities, and became increasingly interested in the market-making aspects

of that business. And as a result, it increased its presence as an option trading firm on the floor of the options exchanges, and was of course a clearing member in the Options Clearing Corporation. And --

Q. And, Mr. Leitner, were you involved in any acquisitions of exchange-traded derivatives businesses while you were working for Goldman?

A. Well, essentially two. I mentioned J. Aron & Company, which was basically a commodities trading firm that the firm bought in about 1980, and they had -- they were extensive traders in what we call physical commodities -- gold, silver, oil -- as well as in the -- Goldman Sachs itself was more involved in the financial futures products, like equity options and futures on the S&P index.

The second acquisition was Spear, Leeds & Kellogg, which Goldman acquired, I believe, in 2000. And that firm had basically three businesses: It was a market-maker in over-the-counter traded securities; it was a specialist on the floor of the New York Stock Exchange; and it had a business called First Options Corp., which was a clearing business for professional option traders on the floor of the exchange and provided essentially financing for the folks who are in that business, as well as providing clearing services for other broker-dealers, which was a business that Goldman was not in before they bought the firm.

Q. How long did it take to structure and close the acquisition of the Spear, Leeds & Kellogg business?
A. A couple of months. I think the deal was struck on a -- over the Labor Day Weekend, and it was closed at the end of October or early November.
Q. Were you involved in the due diligence that was conducted in relation to that transaction?
A. Yes, specifically in connection with the clearing businesses that involved listed derivative products.
And I'm going to use this term very often instead of "exchange-traded derivatives" because that's the way we talk about it in the business. We distinguish between products that are listed on options, like exchange-traded options and futures, from swaps and other OTC-type derivatives. So I may use the term "listed" a lot when I mean those products.
Q. In connection with the due diligence that was performed on that acquisition, were you involved in the assessment of the risks associated with that business?
A. The firm was interested to know two things: how -- whether their operations were sound, and what systems they were using and also what mechanisms they were using to manage the risk of those clients for whom they were essentially extending their -- extending credit. I also was involved in the, sort of, legal due diligence to make sure that they were compliant with laws and regulations to look at their disciplinary history and

any problems relat -- associated with that business. You obviously want to find out, you know, where the hidden traps are that you might have to deal with going forward, and also to make sure the business is well-run.

I'd always been interested in the operations side of the business. So -- and that was especially important in the futures area, where I was tutored by some very excellent folks from the -- what happened on the floor of the exchange through the clearance and settlement process, and I wanted to know how that business, which we were not then doing, was run. So I made a couple trips to Chicago and spent a lot of time looking into it.

Q. You mention in your report various industry associations that you were a member of. Can you describe generally for the Court those associations and your involvement?

A. Well, on the industry side, I've always been a member, since almost the time I joined the firm, in the Future Industry Association's Law & Compliance division, and the Securities Industry Law and Compliance Division. There was also an industry association called the Bond Market Association; so I was very involved there as well. Eventually they merged and became something called SIFMA; so that's now the umbrella securities-related organization. So I've been on committees that worked on issues of common interest.

For purposes of this case, I guess the one most closely

associated -- I was ten years as co-head of something called the Ad Hoc Reg (sic) T Committee, which was moving to get regulatory reform in the area of margin regulations, and we accomplished several major regulations and rule-makings, which I've, frankly, been involved in ever since.

Q. Did you also do work on committees for regulatory agencies?

A. Yes. I was -- I had at least two engagements that I can remember; one was the Market Transactions Advisory Committee, which was an SEC formal advisory committee that was set up by -- at the urging of Congress to determine whether or not there should be a uniform national law for -- regarding interests in securities, how the securities system was held. That's Article 8 of the Uniform Commercial Code. And the second industry committee I worked on was the -- I also was a member of the CFTC Technology Advisory Committee. And for the Industry Association, I worked during the time when there was -- when Congress had passed legislation in 1999 permitting the trading of securities futures products, and the goal there was for the two trade associations to work with the staffs of the SEC and the CFTC to figure out what those rules should look like. So I was the head of the legal regulatory subcommittee of that trade association to work with the staffs.

Q. And could you describe generally the types of risks in relation to exchange-traded derivatives businesses that you

have focused on in the course of your career?

A. I think I've focused on all of the risks associated with this business at various points in time. Very often these risks arose because something happened in the marketplace or something happened to the firm, but fortunately in many cases they happened to somebody else but we learned from it. One significant event was the market break in 1987 when the markets virtually crashed in a very short period of time, both the futures markets and the securities markets, and there were delays in the settlement system, particularly in the option marketplace.

The -- clearance and settlement, which is a big issue in this case, depends upon things happening on time. And there is zero tolerance when payments or margin requirements are not made when they're supposed to be made. And there were delays in payments over the course of that incidence. The firm asked me to work with a risk group to assess what our risks were to these clearinghouses: what happens if they default; can they call on us for more money; under what circumstances can they call us for more money; were there -- in other words, we were trying to rate the financial solvency of the clearinghouses that we dealt with. So that was kind of the first time I took an in-depth look at all of the rules, how they worked, and indeed to eventually move with other industry members to effect changes, not only in the clearing system but also in the legal

regime, and here I worked with the Federal Reserve, Bank of New York and a group of other lawyers in getting amendments to FDICIA, the Federal Deposit Insurance Corporation (sic) Act, to clarify the rights of clearinghouses to net obligations owed by clearing members and to settle those obligations on a net basis. So there was a lot going on as a result of, you know, that market break.

Similar events: There was the Long-Term Capital incident. Long-Term Capital Management was a big firm that went under. They were heavily involved in the derivatives area. And, again, it was an opportunity to assess essentially counterparty risks, different kinds of risk. But essentially it's the credit risks and market risks associated when people have concentrated positions in the marketplace and there's a lack of liquidity in the marketplace, positions -- how can you exit the market, how can you protect yourself.

So there were industry groups that I worked on. In fact, Lehman and other firms were also involved with their counsel to -- it eventually resulted in the writing of a report called "The Counterparty Risk Management Group" that tried to assess those risks.

MS. BLOOMER: Your Honor, we offer Mr. Leitner as an expert in the exchange-traded derivatives industry. And we understand from opposing counsel that they have no objection to his qualifications.

MR. MAGUIRE: No objection, Your Honor.

THE COURT: Mr. Leitner is accepted as an expert in that area.

MS. BLOOMER: Thank you.

DIRECT EXAMINATION

BY MS. BLOOMER:

Q. Mr. Leitner, please describe generally your review of the facts of this case in the course of preparing your expert opinions.

A. I began by looking at all the documents that were relevant to the case: the asset purchase agreement, the clarification letter, the documents relating to the transfer of the listed positions; that would be the assignment, and transfer and assumption agreement, and the collateral agreement. I also looked at the Court's order, the sale order in this case. Then I also obviously talked to a lot of people. I was particularly interested in finding out what the Barclays people knew at the time, what information they had when they got it. So -- and I also talked to the operations people. I always find that their view of what's going on is very critical to understanding the -- you know, what was happening at the time.

I read depositions, participated and reviewed declarations of various parties and, you know, tried to -- and looked at, you know, hundreds of documents and business records.

Q. Did you speak with lawyers for Barclays who were involved

in the transaction and who have testified in these proceedings?
A. Yes.
Q. Do you recall who you spoke with?
A. Ed Rosen.
Q. And do you know Ed Rosen professionally?
A. Yes.
Q. In what context?
A. Ed Rosen has been counsel to several of the committees that I worked with for the trade associations. He and his firm Clearly Gottlieb, his colleague Robert Cook, who's now director of trading and markets at the SEC, were counsel that I worked with very often. So we've had a twenty-five year professional relationship.
Q. Could you please summarize for the Court the opinions that you have formed in connection with your work on this case?
A. Simply put, I concluded that the only rational way that Barclays could have entered into this transaction was by being assured that the collateral securing the listed positions that it was going to be responsible for at the closing were part of the deal and that, secondly, that the -- from Lehman's point of view, that was also a rational decision to make given that the failure to accomplish the transaction and transfer those risks to Barclays would have left them with the possibility of losses exceeding the value of whatever collateral they had.
Q. Could you turn, in your --

MS. BLOOMER: Your Honor, we've distributed a binder. I believe --

THE COURT: I have it. Thank you.

MS. BLOOMER: -- you have a copy.

Q. Mr. Leitner, could you turn, in your binder, to tab 2, which is BCI Exhibit 340? Is this the report that you submitted in these proceedings?

A. Yes.

Q. And does this report accurately reflect the opinions that you have formed in the course of your work on this case?

A. Yes.

Q. Have you reviewed documents and information about these proceedings since the time of this report?

A. Yes.

Q. And have those -- has that review caused you to change any of the opinions in this report?

A. No. On the contrary, they have reinforced the conclusions that I've reached.

Q. Could you turn to page 54 of your report, please? And we can put that up on the screen for you as well.

Can you describe what this last page of your report reflects?

A. Well, I tried to summarize the basis for, and also to summarize, the conclusions and opinions I reached in this matter.

Q. And they accurately reflect the bases for your opinions?
A. Yes.
MS. BLOOMER: Your Honor, we offer BCI Exhibit 340 into evidence.
MR. MAGUIRE: No objection, Your Honor.
THE COURT: It's admitted.
(Report prepared by Anthony Leitner was hereby received into evidence as BCI Exhibit 340, as of this date.)
MS. BLOOMER: And, Your Honor, we prepared a slide of this page of Mr. Leitner's report, and then a separate slide showing each one of those individual conclusions.
Could you please put the first one of those up on the board?
Q. This -- so this is the first of the conclusions from page 54 of your report, Mr. Leitner?
A. Yes.
Q. Now, here you say "Being unsure of the scope of the market risks it was assuming in the ETD accounts, how much potential funding exposure it faced in taking on these positions, and unknown potential losses due to default by LBI affiliates for whose positions Barclays was now responsible, and being acutely aware of the market volatility at the relevant time, Barclays would not have been willing to take on this business without receiving all of the posted collateral, including any clearing-fund deposits."

Could you first explain why you say that LBI's exchange-traded derivatives accounts carried market risk?
A. Yes. I mean, the -- all of the listed derivatives, whether they were options or futures, were based upon the value of an underlying asset, a stock, or an index of stocks, or some other component. And it was also based on the future performance of that underlying security. Therefore, the value of the derivatives themselves are going to move -- their price or value was going to move with the value of the underlying commodity. The more volatility there is in the product, the more they will move.
There is also market risk in several other sense (sic): There is the risk that there will be no market; there will be the risk that there will be expenses in trading in the market. So there are a variety of components to the concept of market risk. But, you know, essentially, and particularly in futures, the amount of loss is -- could be significant. Similarly with regard to the selling of options, the losses could be considerable depending on where the market moves and whether or not you're hedged.
Q. Okay. Now, do the margin requirements on an exchange-traded derivatives account inform an understanding of the amount of exposure to market risk?
A. Yes. In both the futures markets and the stock markets, the clearinghouses and the rules of the securities regulators

require that short positions be covered by some form of collateral to assure the future performance of that obligation. In the case of the clearinghouses for options, the Options Clearing Corporation, what they use for Barclays' proprietary accounts, the ones that they were directly responsible for, they basically took all of the positions, whether they were positions that Barclays had bought and paid a premium for, as well as those they had sold short, and they put them together, applied a formula to determine the outside exposure or risk of loss were there to be a liquidation of that portfolio. So the amount of margin reflected the clearinghouse's goal of protecting itself.

Q. Mr. Leitner, you said a few times today "Barclays" where I think you meant to say "Lehman". So I just ask that --

A. It would be --

Q. I'll try to clarify when you --

A. This is a generic consequence. The general point is that that's the way that you define the risk, whoever has the positions.

Q. If you could turn to tab 9 in your binder, which is BCI Exhibit 646? And we can put that up on the screen.

Are you familiar with this chart, Mr. Leitner?

A. Yes.

Q. In general terms, what information does this chart reflect?

A. Well, this is the Lehman Brothers positions in the various accounts for which they were responsible at the Options Clearing Corporation. And when I say "various accounts", I mean they as a clearing member had responsibility for all the positions they had, but the Options Clearing Corporation allowed you to have -- allowed a member to divide their positions into different categories. So some of these represent positions for the firm itself, for the firm's market-making activities and, separately, for customers.
Q. And each one of those accounts are set forth across the top of each of these pages --
A. Yes, each of --
Q. -- is that right?
A. -- each of the accounts. So 074C is the customer account, and 074F and M are the proprietary accounts.
Q. Okay.
A. And what this chart also shows is the daily requirement computed by the OCC in the morning, based upon the previous night's closing values, and applying the formula for all the positions held in the account. It also shows the composition of the margin held there.
Q. And what is the source of the information on this chart, to your understanding?
A. They are reports generated, in the ordinary course of business, by the OCC, that are provided to the clearing member.

Q. And did you verify the accuracy of the data on this chart by reference to those reports?

A. Yes. I was given a -- copies of all the reports for all the relevant dates described here and I compared them to the numbers that are shown in the chart, and I compared every one for the week from the 15th to the 19th and then a couple of days into the following week, and then I spot-checked them for other dates in the period through the end of October --

Q. So this --

A. -- and they were accurate.

Q. -- table shows the data from September 15th through October 31st --

A. Yes.

Q. -- in reverse chronological order --

A. Correct.

Q. -- is that right?

MS. BLOOMER: Okay, could we go to the last page, please?

Q. So the bottom table on this chart shows the information about the accounts on September 15th, the morning of Monday, September the 15th?

A. Yes.

Q. And you mentioned OCC's margin requirements and your ability to understand market exposure and risk based on the size of those requirements. Where is that information

reflected on this chart, and why is it significant?
A. Well, it's reflected in the top line for each date, for each account. And then on the far right, there's the total requirement, which was essentially Lehman's requirement, which on Monday was 789.6 million dollars.
Q. And why -- is that figure, if at all, significant to your conclusions?
A. Yes. I mean, it's a -- it's significant because that number wouldn't be a requirement if there wasn't risk in the position and risk of loss in any account which had a requirement. So it reflects a computation by the OCC that says 'You've got risk. You have short positions. They're not offset by any long positions you have, and therefore you need to put up collateral to secure me,' the clearinghouse.
Q. Mr. Leitner, why would a broker-dealer carry these positions that, as you say, represent risk?
A. Well, for -- there are a number of reasons. Lehman Brothers was in businesses that were very familiar to me, and one of the purposes of my investigation was to see whether I could understand whether what Lehman Brothers was doing was familiar to what I knew Goldman Sachs did, so I could kind of compare these issues. And Gerry Donini was the head of the equities area or -- in -- or one of the senior executives in the equity area of Lehman Brothers and we had a chat, and I was convinced that their businesses were very similar.

So, essentially the firm would take on proprietary option positions for several reasons; number one, they had a securities trading business. They were also active in the options markets, so -- as participants in that marketplace, so they would be expected to have an inventory of options, including what we call client facilitation. If an institution came and said 'We want to trade. We want to have a position in options of', let's say, '1,000 contracts' or '10,000 contracts, representing 100' -- 'up to a million shares,' that's very difficult to execute on the floor of the exchange. So a firm like Lehman or Goldman would say 'Okay, I will take the other side of that position and eventually trade out of it. So I will do essentially a block trade in options.' So some of those positions would be done as a result of positions that happened to exist at the time, as a result of client facilitation.

Q. Now, are you saying there, Mr. Leitner, that they would -- that Lehman would use exchange-traded derivatives to hedge exposures that it took on in the over-the-counter --

A. Well, in that case it wasn't hedging anything; it was taking on pure risk. It might have a hedge-on in the equity markets. So say that the client wanted to buy calls. Lehman would sell calls. If Lehman sold calls, it was then at the risk that if the underlying value of that stock went up, it would be exercised. They'd have to deliver the stock and, if

they had to trade out of it, they lose money.

So what Lehman would do would be to apply a model to say 'Okay, how many shares of the underlying stock do I need to own to protect myself against the possibility that that option will be exercised?' So Lehman would have gone in the marketplace and bought stock to hedge itself against that option position.

The significant issue here was that, although the parties may have thought that 'Well, gee, you know, that's great. I'll take that over,' the fact of the matter is that in the event -- that stock wasn't there because it had been -- it was gone by the time -- or close to the time this transaction was done. So you -- so Lehman Brothers winds up only with this short call option position for which it has risk and no protection on the other side.

But the other businesses that they did were, you know, in connection with providing solutions to customers' desires to hedge their own positions. Again, it's like facilitation. Customer says 'I have this position; I want to protect it. And' -- 'But I want to protect it for three years.' Well, there's really a very illiquid market for a three-year option. So Lehman might take that position as an over-the-counter position, that is, a private negotiated contract, and then turn to the marketplace to hedge that risk, both in options and in the underlying security. That's exactly the kind of business it did -- that Goldman did and that Mr. Donini assured me that

Lehman did as well.
Q. And what significance does it have to your opinions, if any, that there were over-the-counter positions that were related to some of the exchange-traded positions that Lehman --
A. Well, it would just be -- have been a part of a book of business that a going concern would have. But the -- these over-the-counter derivatives were excluded from this deal. They were not part of it right from the beginning. One can understand that because, you know, under, as I understand, the rules relating to them, most of these transactions provide for the ability to close them out, and you would either -- so the ability to transfer them would be subject to the client's potential desire to just get rid of them and exercise their rights to close them out, or they would require that each and every contract be novated by agreement. You have to sit down with the other side and take them on.
One of the reasons that Congress is discussing a common clearinghouse for these kinds of products is precisely because it's very difficult. I had been involved in that when -- another event in the marketplace, when Drexel Burnham collapsed and Goldman stepped in to buy their book of forward contracts in the Ginnie Mae market. They fortunately only settled once a month, and so we had two weeks to novate, you know, eighteen billion dollars of contracts. But, you know, no way you could do that under these circumstances with this book, so it wasn't

included; made a lot of sense.

Q. Now, if we could turn back to slide 4, which is -- or tab 4, I'm sorry. You say here --

MS. BLOOMER: The prior one, please.

Q. You say here that Barclays was unsure of the scope of the market risks it was assuming in the ETD accounts. Based on the facts that you have reviewed, do you believe Barclays could have quantified the risk position of the exchange-traded derivatives that it was acquiring?

A. In this period of time, no.

Q. Why not?

A. It didn't have -- number one, it was very late getting the information that it could have used to assess the risks, but it also didn't have all of the information it needed. For example, there was testimony that they didn't know until well after the closing where all of these -- where all of the foreign futures accounts were held, what clearinghouses, what the positions were, what the clearing banks were, and so forth.

With regard to the U.S. market and the equity derivatives market and the Options Clearing Corp. positions, what they got was, you know, huge lists of all the option contracts. They later -- they were -- they found out, in the course of assessing that, that some of these included the OTC contracts -- OTC options they weren't getting, and they also did not have the capability of taking this file and loading

that into their own system so that they could assess the risk.
Q. Do you have an understanding of the --
A. By -- that operational issue, by the way, was, you know, a separate set of issues and risks for Barclays right from the beginning.
Q. Do you have an understanding of the number of positions that were in that equity options portfolio that you were just discussing?
A. My understanding is it was, like, 80,000.
Q. Incidentally, do you recall how long it took after the closing for Barclays to form a full picture of the open positions that it had acquired?
A. I believe it took about two weeks for them to be able to migrate those positions onto their own books and records, even though for clearing purposes some of the bridge accounts were still in place, but just so that they could in fact see the entire book and start to work out of the positions or hedge them in a way that made sense.
Q. And what about the futures positions that you said it took time for Barclays to even learn about? Do you know how long that took?
A. You know, I don't recall, but in some cases I think it was, you know, well over a week or more.
Q. Now, are you familiar with what's called a VIX position?
A. Yes.

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Q. Can you describe generally your understanding of that type of position is?
A. It's a Chicago Board Option (sic) Exchange product that is -- where the underlier -- all these transactions, all these contracts have some underlier, the underlier is volatility. Volatility is a measure of market moves. And so it is also a component in pricing options. So the VIX is -- was a comp -- VIX was based on the underlying movements in the S&P index.
 And Barclays discovered, after the transaction -- or while the transaction was closing over that weekend, that there was a position in VIX futures, which apparently represented thirty percent of the open interest, that they hadn't known about at all and for which Lehman had been, and Barclays was going to be, now fully exposed.
Q. And why would they be exposed on the VIX position? Did it have something to do with the market circumstances at the time?
A. Well, I mean, as I indicated, in -- among the market and trading risks are the difficulty in exiting a concentrated position. Your ability to execute it at a fair price depends on how much liquidity there is in the marketplace. If you own, you know, a position of 10,000 of whatever and it only trades, you know, 500 a day, it's going to take you a while, if you put that block of 10,000 whatever onto the marketplace -- well, let's put it this way: People will take advantage of you. And so a forced liquidation or a liquidation where you have to show

your hand, and it would have, I think, become pretty obvious that -- you know, who owned what in the market, that that represented a significant risk, in addition to the fact that it could potentially further deteriorate just as a result of continuing moves in the marketplace. So if they're short, the VIX -- and I understand it they were making a bet that the VIX would go down. Well, it went up. So as it goes up, they're losing money.

Q. Can you please turn to tab 5 in your binder, which is BCI Exhibit 290?

A. Yes.

Q. This is an e-mail dated Monday, September 22nd at 19:38 GMT time, which I'll represent to you is 3:38 p.m. Eastern Time on the afternoon of the closing. And this is an e-mail from Stephen King to various individuals within Barclays.

Stephen King writes in this e-mail on Monday afternoon, after the closing, "It is clear that LB has absolutely no idea what its OCC risk position is. We know it is between two billion short and four billion long. They do not know what has been booked to what entity. We cannot see. We are now four days into making zero progress on this with them." You see that?

A. Yes.

Q. Did you review this in forming your opinions in this --

A. Yes.

Q. -- case? And can you describe what significance, if any, this communication had for your opinions?

A. Well, again, what had happened -- we haven't discussed this yet, but what Barclays found over the weekend was that it had no hedges against this -- these positions -- these option positions. So they represented pure naked risk to them. Point one.

Point two: Because the -- there's evidence that the positions that they had -- that Barc -- that Lehman had at the Chicago Mercantile Exchange had been liquidated on Wednesday, they also would have had no S&P futures, one way or the other, to potentially modulate whatever risk was here.

So what Barclays found on Monday -- what they didn't know was whether this portfolio of exposures was sensitive to the market going up or down. So in order to put a macro hedge on that position, which is all they could do as soon as the closing happened, they would need to know what the sensitivity of that book was, even without knowing all the other issues related to the book.

So this just demonstrates that, you know, a senior executive at Barclays, who was in fact responsible for trying to hedge the book, didn't know whether he should be going long or short on Monday.

MS. BLOOMER: If we could put the slide at tab 4 back up on the screen.

Q. You next say that Barclays -- that there was unknown potential funding exposure that Barclays faced in taking on these positions. What do you mean by "potential funding exposure"?

A. Well, on -- we discussed that there was a requirement imposed by a clearinghouse for listed derivatives to protect itself against exposure. And we saw -- I looked at the chart with you before that indicated the composition of the various margin that was held. What Barclays would need to know is whether or not on Monday, when it took responsibility for the positions, whether it would have to provide additional collateral, because basically the OCC says 'Well, based on market moves and other factors, you know, you had a billion dollars there on Friday but we need two billion today' or 'a billion-five, so put it up.' So that's a -- that would be a risk, even if all the margin's coming over. But if no margin's coming over, then they have to know what their potential exposure -- they would have to totally fund these accounts on day one, and they would have to have been engaged in figuring out what that would be.

So the point is that, absent a deal to make sure that these -- the collateral came over, they would have had to arrange for the provision, and it made no -- they took no steps to do that. So from their point of view, they didn't have to. Well, I shouldn't say they didn't have to. They might have had

to, because, as I said before, the collateral coming over might not have been enough, but that would have been something potentially they could have dealt with. But this is aside from the fact that the clearinghouse itself would have taken steps to assure itself that that collateral was fully funded, which OCC of course in this case didn't do since they were transferring the whole account.

Q. Now, turning back to tab 4 and the slide, you next say that Barclays was facing unknown potential losses due to default by LBI affiliates, for whose positions Barclays was now responsible. What were you referring to there?

A. Well, Barclays' clearing business, and, you know, this is a -- this is something that my former firm does too, it clears positions for all of -- for the entire business, wherever it is in the world. So you do business in foreign countries through affiliates. They had big -- a huge business in London. So those London affiliates were doing a lot of the same things for foreign clients that the U.S. firm is doing for U.S. clients.

So to the extent that it required listed derivative positions, it was using Lehman to clear those positions. It was doing it in -- as the -- my understanding of the record shows, in discussions with the operations people, those positions were carried in some cases in the firm accounts, and in some cases in the customer accounts.

So what you had was Barclays' willingness in this deal to

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take over all of the clearing requirements for those positions without knowing exactly what they were, because they were all mixed up at the time; it took them a while to figure out, you know, as someone said, you know, Barclays' -- 'Lehman's books are screwed up.' I don't know whether that's true, but that was the perception on the part of the operations people at the time. They couldn't figure out what the positions were.

So whatever they were, they had -- any losses that would result from them -- so even though they weren't taking on those affiliate accounts as customers, they still had the clearing responsibility for them. And if there were losses, they would have to turn back to make a claim against somebody. But those affiliates were already, you know, filing for bankruptcy at the same time that Lehman was. They were all insolvent.

Q. And the fact that they were insolvent, how does that -- how is that significant to the risk that Barclays was assuming?

A. It means you're unlikely to collect whatever losses you incur as a result of getting out of the positions.

Q. Would Barclays, upon taking clearing responsibility for LBI's exchange-traded derivatives accounts, also be exposed to credit risk in relation to nonaffiliate customers?

A. Yes. I mean, customers -- they were clearing for customers who had, you know, positions that created risk. The theory is that all those customers are required to post margin themselves and to have sufficient assets to cover the

positions. But you are at the risk that customers, in the event -- as a result of a major market move or something like that, will not be able to meet their obligations, and you will have to liquidate those customer positions and risk loss. So if you don't get the margin along with the client accounts -- I mean, that's some mitigation against that possibility, but that was the risk they incurred.

So I don't think that it was a risk that should be ignored, and they didn't -- but they were willing to take, you know, a whole group of the customer accounts. There was credit risk on the derivative positions.

Q. Did the market conditions during the time of this transaction, in your view, have an effect on the extent of that credit risk?

A. Obviously it would depend on, you know, the position of each of the clients, but as -- in a general context, yes. The market was very volatile at the time, and so, depending on whether the clients' positions were sensitive to the market going up or down, particularly if they were sensitive to the market going down, you could have a serious call on the client that they wouldn't be able to meet.

I mean, look, the majority of firms in this business, particularly in the futures business, that have gone under have been brought under as a result of client defaults and their inability to meet margin requirements. So it's not, you know,

an insignificant risk.

Q. Now, if we go back to tab 4, which is the slide -- next thing you mention is the market volatility at the relevant time. And can you please turn, in this regard, to tab 9 of your binder again, which is the margin chart that we were looking at earlier, BCI Exhibit 646?

A. Yes.

Q. Can you explain to the Court the ways, if any, in which the market volatility are reflected on this chart?

A. Well --

Q. And please turn to the last two pages -- last page.

A. Yeah, we're talking about pages 7 and 8. And starting with page 8 and working backwards, or up the chart, the volatility is reflected by the degree to which the margin requirements go up or down in a given day. And we can see that the margin requirement goes from 789.6 million, in the aggregate, to 1.36 billion, in round numbers, on the Tuesday, based on Monday night's close. So -- and I say in my report the market dropped from Monday to Tuesday. So that would indicate a sensitivity to the market going down.

Then the next day there's a slight increase in the margin requirement. But between Monday and Tuesday we have an almost 500 million dollar change in the margin requirement; it's, like, you know -- I didn't figure the percentage, but it's a significant percentage change.

And then it goes on the following day from 1.4 -- this is from the 17th and flip over the page to the Thursday morning -- it goes to 2 billion, from 1.4 to 2, which is another 500 million.

And then based on Thursday night's close, the margin requirement on Friday morning has gone down again by another 500 million.

So you have a fluctuation. If you're just thinking of the volatility of the margin requirement, you see it going up by twenty-five to thirty percent, in round numbers, from one day to the next. That's a pretty huge variation.

Q. And what significance does that market volatility in these particular accounts have, if any, in relation to your opinions concerning the risks that Barclays was undertaking in acquiring these accounts?

A. Well, let me start by emphasizing that, during this period of time, this is Lehman's risk. And, you know, we can't lose sight of the fact that if this transaction closed, this would have been all Lehman's risk. So what Barclays was doing, you know, for, frankly, from my point of view, the marketplace as well as for the transaction in this case was a willingness to take on all of this exposure at whatever volatility this meant, without having a lot of facts, and its only mitigant was its ability to take the margin along with it.

So what this chart tells me is that -- and what, actually,

the record developed over the weekend shows, is that nobody knew what that margin requirement was going to be on Monday morning. In fact, there was some indication by the OCC that they might, you know, have a very significant deficit.

The other -- by the way, the other set of risks that we haven't even discussed is the fact that on the Friday, that was an option exercise date. That means all these options that were short, that were expiring on that date, that were in the money, were going to get exercised. There was a settlement obligation that someone had to perform; that settlement obligation -- that's to make delivery on all these contracts -- that settlement obligation was assumed by Barclays over time. If this deal hadn't closed, then Lehman, the estate, and the OCC would have been in charge of figuring out how to settle all those bargains and make the payments.

Q. Mr. Leitner --

A. So this was a pretty critical period for lots of reasons, but that was one of them.

Q. You mentioned the possibility of a deficit. Could you describe for the Court what you mean by that?

A. Well, we're talking about deficit here in terms of what the -- only what the margin requirement is that OCC is computing. OCC is using its models; it's saying, you know, 'Our view of the risk of loss is X.' And so a deficit would mean that, under the rules of the Clearing Corp., you would

have to meet that deficit within a certain period of time on the next business day.

I told you earlier that this market is very dependent on things happening when they're supposed to happen. There is a low tolerance for being late in making payments and settlements. And so, you know, if there had been a deficit, that would have been Barclays' requirement on money.

Look, you can -- just to take a look at the chart again, if you look up to the 30th of September, the margin requirement had gone up to two billion dollars. And, again, you know, the volatility of that margin requirement in the prior week had been 500 million dollars, more or less, from potentially one day to the next.

Q. Now, Mr. Leitner, while we're still on this chart, let's pause for a second to talk about the composition of the margin in these accounts. Is that composition in the margin reflected in these charts as well?

A. Yes. You could -- just take a look at the 15th, for example. The 15th shows that the margin requirement of 789 million had been met by nine hundred and almost forty million dollars of treasuries, and 330 million of what are described as LCs, which are letters of credit.

Q. Okay. And in the course of your work on this case, did you come to learn about LBI's practices for how it funded its exchange-traded derivatives margin requirements?

A. Their practices were very similar to the ones that I was familiar with, which is that you used letters of credit and treasuries generally as the cheapest way of meeting your margin requirements, because if you reverse in treasuries, the carry cost could be less than using cash. Cash is expensive, so you try not to use it.

Q. Now, if you look at this chart, although there's zero cash in the accounts on September 15th, by the end of the week, on September 22nd --

MS. BLOOMER: If you could turn to the next page, the 22nd.

Q. -- you see cash of over a billion dollars --

A. Yes.

Q. -- do you see that?

A. Yes.

Q. Do you have an understanding of what factor or factors contributed to the buildup of cash in this account over that week?

A. My understanding is that, you know, as a result of the fact that Lehman was in distress, financial distress, that their -- the banks that they dealt with that were essentially funding their operations were beginning to pull back, and that specifically they found it more difficult to reserve in treasuries and they needed -- so they wound up having to use cash, that they would otherwise have used for that purpose, to

fund their margin requirement

Q. And so is it your understanding that LBI had to deposit over a billion dollars in cash in that one week in light of that event?

A. Well, that's -- that -- they met the requirement. That -- the requirement was the requirement. And to the extent they couldn't use their normal strategy of reversing in treasuries, they had to use cash.

Q. Would an acquirer of an exchange-traded derivatives business typically attribute significance to the allocation or composition of margin in an account as between cash and securities?

A. No, not really, because all you're concerned about is the fact that the margin was good enough for the clearinghouse. It's good enough for the clearinghouse, it's fine. The problem would be whether some portion of that margin was being covered by letters of credit. They're acceptable to the clearinghouse, but those are contracts with the prior clearing member, and so you would have to find arrange -- make arrangements, if you wanted to use letters of credit, to find your own banks to provide them.

Q. So to the extent that LBI was using letters of credit, and here it shows they were using 252 million dollars' worth of letters of credit to fund their margin requirements on September 22nd, would Barclays be expected to receive benefit

of value from that, or would they have to replace those letters of credit?

A. Well, theoretically they would have to meet the requirement and they couldn't use the letters of credit that were there, if I've understood your question correctly.

Q. And what significance does that risk, if any, have to your opinions?

A. Well, that's part of the funding risk that I indicated before, that is, the need to know whether you have to come up with additional collateral, and then figuring out what's the best way to do that.

Q. And finally, Mr. Leitner, with respect to this chart, it shows you that as of the morning of September 22nd, there were 926.8 million dollars' worth of treasuries --

A. Right.

Q. -- in this account. That reflects to you that this was not purely a cash margin account, is that right?

A. No. No, I mean, look, again, the practice is to try to meet your margin requirement in the cheapest way possible, and that generally is by reversing treasuries which have some income component to it. So if you're in the business, that's a cheap way to do it. So that's the way most firms do it. That's what I assume Lehman was doing.

Cash is more expensive. You can put cash to work in other ways. So you wouldn't do it as a matter of choice. And indeed

the testimony from Mr. Jones, Craig Jones, who was running this business, was, you know, they -- treasury -- their treasury department was being forced to use cash.

Q. Now, if you'd turn to tab 12 of your binder, which is your next conclusion that we have put on a slide. You say "Absent Barclays' assumption of LBI's obligations with respect to the exchange-traded derivatives, this business was in imminent danger of being unraveled by the relevant exchanges in clearing corporations through the medium of a forced liquidation of the positions in LBI's ETD accounts."

A. Yes.

Q. What was your basis for this conclusion?

A. Well, there were a couple: The first one was that it had happened already through the Chicago Mercantile Exchange's exercise of its rights in auctioning off all of Lehman's proprietary positions on the Wednesday, which the Court was told about at the hearings; secondly, the OCC had made it clear on Friday and throughout the weekend that if the deal didn't close, that's exactly what they were going to do.

And let me make a general point that clearinghouses have only one concern when a member goes into distress, and that is protecting themselves and their members. And they begin to look at whatever happens to be sitting in those accounts as theirs to deal with, and in fact they have the right to deal with it as theirs. So a forced liquidation means, just as in

the CME case, is that the clearing member uses -- loses all control over its ability to determine the outcome of whether it's going to get any money back or wind up owing money.

Q. Now, if we turn to tab 16, which is your next conclusion, you say "There was a substantial risk that such a liquidation could result in a loss of much, if not all, of the margin LBI had posted with the OCC and the other exchanges and clearing corporations, and could have resulted in losses beyond those that the posted collateral, including the clearing-fund deposits, would cover, and also result in losses to LBI's customers."

Now, let's focus on the first part. When you talk about a substantial risk of "such a liquidation", you're talking about the forced liquidation --

A. Yes.

Q. -- that you were referring to in your prior opinion? Why do you believe a forced liquidation could result in a loss of much, if not all, of the posted margin?

A. I think it was very important in my reaching that conclusion about two factors: One was the size and complexity of the positions (this would have been the largest liquidation of option positions ever in the United States); and secondly that, at the time, there was a huge uncertainty in the marketplace. You had Harvey Miller telling the Court, and the investment banker for Lehman telling the Court, that if the

transaction hadn't closed, first of all, the -- I think Harvey Miller's words were 'this administration is over'. And the banker's saying, you know, 'The capital markets, as we know it, will be in chaos.' I don't -- that might have been a bit of hyperbole, that last statement, but I was at the stock exchange at the time, helping consult with them on market issues, and I can tell you that there was a huge amount of uncertainty in the marketplace at that time. And so I think it is absolutely reasonable for me to conclude that the -- a forced liquidation could have blown right through all the collateral they had.

And, again, Lehman has no power to manage the liquidation. OCC said they were going to do it, and they would have done it. And every other exchange that they cleared through, all these foreign exchanges, they would have used self-help. That's what they're supposed to do.

Q. And in the event --

A. And they will do it to protect themselves.

Q. I apologize for interrupting.

Did the event at the CME inform your conclusion that such a liquidation could result in a loss of much, if not all, of the margin?

A. Yes. I mean, they -- that liquidation, you know, basically shredded their positions and, what, it cost them 1.6 billion.

Q. Could LBI have mitigated its risk of this doomsday

scenario that you describe, by taking the margin out of its ETD accounts during that week?

A. I'm not sure I followed you. I mean, first of all, they couldn't have taken the margin out.

Q. Well, that's my question, sir. Why not?

A. Well, first of all, the -- they had to keep whatever the requirement was there during the day. And the exchanges also, almost universally but certainly the U.S. exchanges, have the right to do what they call an intraday call. In other words, if they feel that a member is in financial difficulties or if there's particular volatility in the marketplace, they will say 'Just put up more margin.' That happens in the futures markets all the time. Get a call at, you know, 2 o'clock, saying 'We'd like another billion dollars, and we'd like it in an hour.' And they expect to get it in an hour.

Now, what happened here on the Friday was that the Lehman folks, having been told that their margin requirement had gone down between Thursday and Friday, did what they normally did was just try to get the money back. And OCC said 'Eh, we don't think so.' I'm being colloquial, but they exercised their right to, effectively, refuse to return that margin, by implementing an intraday call on Lehman.

So one of the reasons why there was a lot of margin was because the OCC felt itself exposed. And indeed what I think they were doing is protecting against the possibility that the

deal wouldn't close.

Q. Now, did the other exchanges and clearing corporations have similar rights and powers and incentives as those of the OCC?

A. Yes.

Q. Can you turn back to slide 4, which is at tab 16 of your binder? You next say that a liquidation could have resulted in losses beyond those that the posted collateral would cover.

A. Yes.

Q. Are you saying that, absent this deal, LBI could have lost more than the margin that it had put up with the exchanges and clearing corporations?

A. Yes.

Q. Why is that?

A. Well, for the reasons I've stated before, that, number one, they had no control of it. You were perfectly at the control over the liquidation processes -- the clearinghouse's control. So they have to figure out how to do this. Now, they're going to try to do it in an orderly way, but understand that in this instance, in these circumstances, if the deal hadn't closed, the -- how would the markets have reacted to that? The markets were expecting the deal to close. If it hadn't closed and the OCC was now going to exercise its rights and other exchanges were going to exercise their rights, the OCC -- the whole portfolio would have been at all the market

risks I just described before: spreads would have widened; liquidity might have dried up. You just don't know what those consequences were.

So I think it is completely reasonable to conclude that most all or more than the amount of collateral that was held, which was what the total as -- you know, whatever it was, one-point-something billion dollars, would have been insufficient to cover the complete liquidation of those positions. Do I know that for a certainty? Of course not. One has to speculate on what would have been the likely outcome in the marketplace at that time, and that time was pretty unique --

Q. Does that opinion --

A. -- fortunately.

Q. -- hold true even though there was an excess in the OCC accounts as of the Friday morning?

A. Yes, because, look, what does an excess mean when the margin requirement's moving 500 million dollars a day? I mean, the margin requirement on the -- let's look back at -- can I look back the tab again? What was the number?

Q. Sure.

MS. BLOOMER: Can you pull up --

Q. I believe it's tab 9 of your binder.

A. (Pause). Sorry, I got it the wrong way around.

So the Friday requirement, the 19th, the morning

requirement is 1.6 billion, and the requirement on Monday morning is 1.5 billion. And the requirement on Tuesday is 1.7 billion. I mean, so, you know, it looks to me like the aggregate margin requirement, you know, went up.

Q. And did you investigate whether that trend continued after the 23rd?

A. Well, I mean, yeah, the chart will speak for itself in terms of what those requirements were, but, you know, it gravitated between, you know, just somewhere in the 1.5 billion dollar range up to 2 billion by the 30th of September.

Q. Now, what exactly would happen if an exchange-traded derivatives account liquidation resulted in losses that exceeded the posted margin, as you say was possible?

A. Well, first of all, if they exceeded the posted margin, the clearinghouse would go to its reserve fund, which is the -- sorry, it would first go to the clearing member's clearing fund deposit, and it would use those assets. Every clearing member has to put up a deposit, which is like an overall equity, and that deposit varies depending on how much business they do.

So -- by the way, that was another thing Barclays had to worry about, because now they were going to have this big position. Their own clearing-fund deposit was going to have to go back. So it would be concerned that, you know, those were part of the assets in the business too that it needed to be able to support the positions.

But just for the purpose of answering your question, it would -- the clearinghouse would look to that clearing-fund deposit. If it wasn't enough, then they would assess the clearing-fund deposits of all the other members. To the extent that they had to do that, then they would look back to the estate to cover themselves against that differential. So if all of the assets that Lehman had were used up and the clearinghouse had to look to the resources of other members or itself to make up the difference, then Lehman Brothers remains on the hook.

MS. BLOOMER: Your Honor, I would pause to note that we are at our typical morning break time. I have about ten minutes, I would say, left --

THE COURT: Please proceed till you finish.

MS. BLOOMER: Thank you.

THE COURT: We'll break when you're --

MS. BLOOMER: Okay.

THE COURT: -- you finish your direct.

MS. BLOOMER: Thanks.

Q. Back to the slide that we were just looking at, at tab 16.

A. Yes.

Q. You mention at the end of this that there was a substantial risk that the liquidation could -- would also result in losses to LBI customers. Can you explain that for the Court?

A. (Pause). If the customer positions hadn't been transferred, the OCC had the right to liquidate the customer positions. They would not have wanted to do so, of course. The whole object in any of these proceedings is protecting the customers, which means moving them to other firms that are solvent. But the fact is that the -- it has happened before that customer positions have been blown out; it happened in -- which, by the way, was one of the cases I worked on on the Market Transactions Advisory Committee assignment had; it was looking into the outcome of something called volume investors. In that case, the Clearing Corporation had liquidated everything, including the customer positions, because actually that was one of those cases where a customer default had brought the firm down. And so in liquidating all the other customer accounts, those customers lost money and, you know, the Clearing Corporation was not responsible for them. So it's -- that's what happens if -- in a here-today-gone-tomorrow scenario.

Q. Could you turn to tab 15 of your binder, please, which is BCI Exhibit 267?

A. Yes.

Q. This is an e-mail from Jim McDaniel to Stephen Harback of SIPC, and various attorneys at Hughes Hubbard --

A. Yes.

Q. -- among others, dated Sunday, September 21st. And it's

responding to an e-mail that Stephen Harback had written to Jim McDaniel and Bill Navin earlier that day.

First of all, do you know Jim McDaniel and Bill Navin?

A. Yeah, Jim McDaniel and I have known each other for years. Jim is -- and I are co-authors of an article on cross-margining that was published in the Capital Markets Law Journal. And Bill Navin I've also known for -- he's now the general counsel. I knew him when he was still a lawyer at Sidley.

Q. Now, Mr. Harback says in this e-mail, "I urge you in the strongest possible terms not to take precipitous action." And this was in response to Jim McDaniel's e-mail from earlier that afternoon, if you'd look at the next page, paragraph 3, where he says, "If the transaction does not close tonight, OCC would need to immediately liquidate and close out the LBI accounts and is preparing to do so."

Now, in response to Mr. Harback's e-mail urging Mr. McDaniel and Mr. Navin not to take precipitous action, Mr. McDaniel responds, and in that response he says, in the middle of that paragraph, "OCC cannot allow the positions to remain in place if no transaction is concluded tonight, because OCC will then be exposed to loss if the market moves against LBI's positions."

A. Right.

Q. You see that?

A. Yes.

Q. Did you review this e-mail when you were forming your opinions in this case?

A. Yes.

Q. And what significance, if any, did this e-mail have to your conclusions?

A. Well, it's -- you know, as I said before, OCC was making preparations and it, frankly, had indicated, I believe, according to testimony, as early as Friday that if this wasn't resolved with Barclays actually taking full responsibility for those accounts, that it would exercise its self-help rights. So this is just confirmation of -- along with other testimony, of what was going on over that weekend. They were getting very nervous.

Q. Now, if you'd turn to tab 18, which is your next slide. You say "For all of these reasons, it was in LBI's best interest to agree to transfer to Barclays the entirety of exchange-traded derivatives business, including all posted collateral and the clearing-fund deposits." What is your basis for this conclusion?

A. Well, as I said before, the -- by the time of the -- on the -- by the Friday, for sure, there was only risk in these positions, that is to say that -- the risk of loss, so that -- particularly with regard to the proprietary positions. So if LBI -- there was -- there were no hedges for any of these transactions. There was nothing that offset the positions. So

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when you have nothing but naked exposure on all of these listed derivative contracts, the margin is a proxy for how much you can lose. But it's not a limitation on how much you can lose.

So I think -- that's why I think it was absolutely in the interest of the estate to assure that this derivatives exposure, which, you know, I'm not sure that, you know, everybody quite understood that at the hearing, but in my view it's one of the largest exposures that the estate faced by that Friday when these hearings were being held before you.

And so I think it was -- as I said, I also think it's in the best interest of the markets, because I don't know how the markets would have reacted if this deal hadn't closed and there had been a liquidation. But, you know, kind of based on my experience walking around on the floor of the stock exchange, it would not have been pretty.

Q. Mr. Leitner, you say that you're not sure whether the other people at the hearing understood the risks associated with this type of a liquidation.

A. No, no, I -- let me --

Q. Could you please turn to --

A. Sorry.

Q. -- tab 13 --

A. Okay.

Q. -- of your binder, which is BCI Exhibit 49A, which is the sale hearing transcript?

A. Yes.

Q. Okay. And if I could direct your attention to page 238 of that transcript --

A. Yes.

Q. -- lines 17 through 21, and this is Mr. Miller addressing the Court towards the end of the sale hearing. And he says, "Look what happened yesterday, Your Honor. The CME closed us out and we took a loss of 1,600,000,000 dollars." And then he says "This administration is finished if this transaction is not completed, Your Honor."

Do you believe, Mr. Leitner, based on that statement, that Mr. Miller understood the risks associated with the exposures in these accounts?

A. Yes.

Q. Now, Mr. Leitner, have you reviewed the contemporaneous evidence and transaction documents that were generated during the time that this transaction was being completed?

A. Yes.

Q. And do you have a view of what the parties understood this transaction to be, based on your understanding of industry practice and the discussions and actions that those parties were undertaking at that time?

A. Are you talking to the last conclusion in my opinion?

Q. Sure.

MS. BLOOMER: Why don't we put that up on the screen.

Q. That's at tab 20 of your binder. You say "The governing agreements are entirely consistent from the vantage point of an industry expert, with a view that the parties agreed to a transfer of the entirety of LBI's exchange-traded derivatives business, including all of the posted collateral and the clearing-fund deposits."

What brought you to this conclusion?

A. Well, again, it's the review of the entirety of the agreements. I was looking for, okay, what was the deal here? When I was first engaged in this matter, I said, you know, kind of, what's -- what is this fight about and why is there a fight at all? And I looked at the agreements and I said, okay, well, they're transferring all these businesses and all the assets necessary to operate the business, so why is there a fight about the collateral, because that's a necessary part of operating this portion of the businesses that were being transferred, the equity -- sorry, the listed derivatives' exposures.

Q. Now, when you reference the documents that you looked at that caused you to lead -- reach that conclusion, were you including the APA in that?

A. I was looking at the APA, the clarification letter, but also all the documents that were created to implement what seemed to be the intent of the parties. Those included the sale order that was presented to Judge Peck that reflected the

fact that the parties had been talking to the OCC about getting this -- getting these accounts transferred. OCC was insisting that its lien against all of the collateral of Lehman Brothers that was going to be transferred to Barclays -- which they assumed was a fact -- was that they maintained the lead in that. That order referred to all the margin, including cash, that was being transferred, and the transfer and assumption agreement, the collateral agreement, that actually implemented that transfer. All of those documents were consistent with an understanding that the collateral's going to move.

Q. And are you aware of a bulk transfer order that was issued in this case by the CFTC?

A. Thank you for reminding me. Again, what did the parties responsible and the lawyers responsible for accomplishing the transaction do to make it happen? One of the things they had to do on the futures side of the business was to get the SEC and CFTC to under -- to permit this bulk transfer.

The reason why it was necessary is because the CFTC and -- the rules look at any transfer of beneficial ownership as a trade. That trade can only happen on the floor of the exchange or under the auspices of an exchange. In a circumstance like this, however -- special circumstances, where an entire business is being transferred, you can get the permission to do that change of beneficial ownership without it affecting the marketplace.

And so -- but you've got to get the CFTC to say it's okay. So -- and the assumption by Mr. Raisler and all the parties working on the futures side and the practice in the marketplace was, that when you transfer futures accounts, you're transferring the accounts with everything in it. And that includes all the collateral that happens to be securing the futures positions in those accounts. That's what the bulk transfer order is designed to do, to make sure that that happens.

Q. And if you look at tab 11 of your binder, which is the bulk transfer order that was issued in this case, BCI Exhibit 843, and you look at the last page of that --

A. Yes.

Q. -- it says, "Accordingly, pursuant to delegated authority, the undersigned," and that would be a representative of CFTC, "authorizes the transfer of the accounts as described above from LBI to BCI." Do you see that?

A. Right.

Q. And is that, to your understanding, an authorization by the CFTC of the transfer of the accounts that housed the futures positions that Barclays was acquiring with everything that was in them?

A. Precisely.

Q. Would you --

MS. BLOOMER: Okay. I apologize, Your Honor. That's

in your binder at tab number 11, but we weren't able to put it on the screen.

THE COURT: I have the letter.

MS. BLOOMER: Thank you.

Q. Now, Mr. Leitner, the last thing I'd like to ask you about is whether you have reviewed the communications between the parties in this case, and whether you have formed a view about what those communications signify in terms of the understanding of the parties to this transaction?

A. I've reviewed the communications of the parties, and obviously, I've reviewed the testimony of many of the witnesses in their depositions and in their testimony before the Court.

Q. And based on your knowledge of this industry and industry practice, what do you understand the parties to have been agreeing to in this transfer, based on what you saw in their communications?

A. That they intended to include the listed derivatives clearing business as part of the businesses to be transferred along with the FCM, capital markets and related businesses, all the assets used in that business, and that would include all the collateral, including clearing fund deposits that were part of that business. That was my conclusion. And that seems to be the roadmap that was provided for the folks who had to execute the transaction and make it happen and was consistent with all the actions that the parties took and was reflected in

the documents, particularly those at OCC that, you know, essentially effected the transfer. And --

Q. Lastly, Mr. Leitner --

A. Excuse me. Can I --

Q. -- are there things --

A. -- go ahead.

Q. -- that you would have expected to see happen that you did not see evidence of, if you believed the parties did not believe the transfer was being -- the margin was being transferred?

A. Well, put it another way. I did not see any action that wasn't consistent with that view for any other alternative to have been accomplished, i.e., oh, you're not getting the margin; or you're not getting all the margin; or we're keeping some of the margin.

You would have had to have a lot of things put in place to effect the transfer -- that is the funding requirement would have had to have been in place at the time, which clearly the parties -- Barclays didn't do. You would have had the parties having some methodology for computing well, how much do you get back; when do you get it back; why should we get it back. I mean, there would have had -- there was no evidence that any of those issues, which would have had to have been accomplished if there was any other deal or understanding, I see no evidence that there was any such discussion by any of the lawyers

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involved or by any of the businesspeople involved.

MS. BLOOMER: Thank you, Mr. Leitner.

Your Honor, I have no further questions.

THE COURT: We'll take a break before cross-examination and return at 11:15.

(Recess from 10:58 a.m. until 11:19 a.m.)

THE COURT: Be seated, please.

And I see I have another book.

MR. MAGUIRE: If it please the Court, Bill Maguire for the SIPA trustee.

THE COURT: Please proceed, Mr. Maguire.

CROSS-EXAMINATION

BY MR. MAGUIRE:

Q. Mr. Leitner, is it fair to say that you have never had any experience involving the sale of a broker-dealer business that was structured as an asset purchase?

A. Correct.

Q. And in fact, you'd agree that it's obviously a much more complicated structure to sell an exchange-traded derivatives business as an asset purchase, than a sale of a company?

A. Yes.

Q. In the sale of a company, there's simply a sale of stock, and all of the assets and all of the liabilities of the exchange-traded derivatives business, all go with the company, right?

A. Yes.
Q. When you have an asset purchase agreement, then the buyer and the seller have to go down through all of the assets and the liabilities and figure out which ones stay and which ones go to the buyer?
A. Generally speaking, yes. Although it's ver -- it would be unusual, except in my experience in the sale of an FCM business, for a -- the closest thing you have is a -- to this case, is the sale of an organization involved in a clearing business. So the -- this sale involved several businesses together that were linked in regard to the equities or the listed derivative business that happened to be included within it.
So although it can be discussed as a separate business, it was also an adjunct of all the other businesses: the trading, marketing, capital markets businesses that were already being transferred -- that were also being transferred. But I absolutely agree with you that it's very complicated to do this in the form of an asset transaction as opposed to the sale of the entire company. Completely agree.
Q. And you'll accept that in negotiating an asset purchase agreement, a buyer and a seller may agree that some or all of the seller's cash will go with the business?
A. In a theoretical sense, is it possible? Yes. Was it possible here? I don't think so.

Q. Yes, of course, the parties can all agree that the cash will not go with the business. Isn't that right?

A. Are we using cash here as a kind of an accounting term? What are we talking about in terms of cash?

Q. As a general matter, the parties can decide to do whatever they want in terms of picking and choosing which assets are going to be sold and which assets are not --

A. Yes --

Q. -- going to be sold?

A. -- correct.

Q. And in a normal transaction, you would expect a buyer and a seller to agree whether or not margin is in the deal or not in the deal?

A. Two solvent parties engaging in an arm's-length discussion. That would be absolutely possible.

Q. Now, here you say that no rational purchaser would buy Lehman's exchange-traded derivatives business without all the margin, right?

A. In September -- my opinion was based on the context. So I'm talking about the period between September 15th and 22nd, 2008.

Q. And that was because of all of the risks that you described on direct: the market risks and the funding risks and the clearing risks, right?

A. Also because it was effectively the -- a forced sale and

the only transaction available. So, you know, for all of the reasons that, you know, I described, the transaction was unique, and I mean unique in every sense and hope it never happens again.

Q. Let me just ask you a little bit about the clearing risks that you testified about --

A. Yes.

Q. -- earlier. With respect to customers, a broker-dealer manages that risk by getting collateral, margin, from the customers. Isn't that right?

A. Among other things, yes.

Q. And they keep that in what are called segregated or seg and secured accounts, right?

A. It's important here to distinguish whether we're talking about futures accounts or accounts in the broker-dealer, the equity accounts. So the -- but -- because segregation is the norm and the requirement in the futures business but not in the broker-dealer business.

Q. In either case, though, the broker-dealer will get margin from the customer. They'll either put it off exchange in a money market fund or whatever, or they'll put it on the exchange, right?

A. Yes.

Q. And you're not aware of any actual loss that Lehman -- that Barclays suffered here as a result of the transfer of the

PIM customers, are you?
A. One of the risks I didn't get into in discussing this was operational risk. And my understanding is that they, in fact, incurred losses as a result of two factors. One was that the Lehman folks were carrying some of the futures accounts for customers in U.S. dollars. But the actual customers had supplied the margin in foreign currency. So the obligation back to the customer was in the foreign currency, which Barclays was not aware of. And so there was a loss in the sense of the conversion of the dollars back to the foreign currency.
The second issue apparently was the -- that some customer positions of Lehman customers that were carried in foreign accounts of affiliates, had been booked in a firm account range and not in a customer range. And so there were -- Barclays had to wind up making up the loss.
But if you ask whether customers themselves suffered losses, I'm not aware -- or sorry, that Barclays incurred losses as a result of any customer defaults, I'm not aware that they did.
Q. You're not aware of any customer defaults?
A. Right.
Q. Now, you mentioned the clearing risks with respect to affiliates, and that's affiliates of Lehman, right?
A. Affiliates of Lehman, yes.

Q. And the risk there was Lehman affiliates would be bankrupt or wouldn’t be good for any margin calls --
A. Right.
Q. -- and that Barclays, in stepping in and taking over clearing responsibility, would get stuck with their losses, right?
A. Yes.
Q. And the clearing risk, you understood, was Lehman's problem in terms of clearing trades for the affiliates. But that would then become Barclays' problem once Barclays took responsibility for the Lehman accounts?
A. That's right.
Q. Now, Lehman had relationships with various clearing organizations, did it not?
A. Yes.
Q. I believe in your report, at page 10 --
MR. MAGUIRE: Maybe we can put it up.
Q. -- you list the various exchanges and clearing organizations. You should find it in the binder that I just left for you, sir, in tab 1, a copy of your report, marked Barclays' Exhibit 340. And if you turn to page 10, you'll see that you list there the -- at the very top of the page, that LBI was a clearing member of several clearing organizations, including the Options Clearing Corporation?
A. Yes.

Q. The CME; the National Securities Clearing Corporation, or NSCC; and the Depository Trust Clearing Corporation, the DTCC. Do you see that?

A. Yes.

Q. And you have at the end of that sentence a footnote that refers to various other exchanges. And that's at the bottom of the page.

MR. MAGUIRE: And maybe we can put that footnote up. That's footnote 1.

Q. And you note there that "The exchanges in which LBI traded exchange-traded derivatives included," and you've a long list there that goes all the way from Osaka to the Kansas City Border Trade, right?

A. Yes.

Q. And Lehman was responsible for all of the liabilities associated with its accounts of the exchanges, right?

A. That's my understanding, yes.

Q. And it's your understanding that when Barclays entered into this transaction, then Barclays was assuming and taking on all of Lehman's responsibility for all of the accounts at the exchanges?

A. Yes.

Q. And in doing so, Barclays was taking on not just the risk of proprietary and ordinary customer positions, but also the clearing risk for all of the Lehman affiliates?

A. In those cases where those positions were being booked for the affiliates. That's my understanding. So that in the case of OCC, those affiliate positions were part of the accounts for which Lehman was directly responsible. I have not parsed through whether, for example, a London Lehman affiliate traded its futures positions in its own name through a foreign exchange or through Lehman. But to the extent that they did, then it would be an example of something that was similar to the situation at OCC, that is to say, that Lehman Brothers Inc. in the U.S. would be responsible for that affiliate's position, yes.

Q. And it's your understanding that since Barclays was taking responsibility for the Lehman accounts at the exchanges, Barclays would get the margin at the exchanges?

A. Yes.

Q. But if Barclays did not take responsibility for the Lehman accounts at the exchanges, then Barclays would not be entitled to the Lehman margin at the exchanges?

A. Right.

Q. Bottom line, Barclays wouldn’t be entitled to the margin unless it took responsibility for the Lehman accounts?

A. Right.

Q. At the exchanges?

A. Well, keep in mind, I think my report makes clear that although they might be members of the exchanges or were members

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through affiliates, their obligation was with whatever party was, in fact, carrying the positions. In some cases those were not the exchanges themselves or the clearinghouses themselves, but they dealt through local brokers or affiliates.

But the same issue would apply. So that in Korea, for example, if Lehman's futures positions for itself and customers were done through a local Korean FCM counter -- you know, whatever is the equivalent of an FCM in Korea, then the margin would be posted at that local Korean affiliate and the obligations, however, would be otherwise the same. In other words, the Korean company would itself have rights that are very similar to the rights of an exchange to exercise self help under the local rules in the event of a default by, in this case, the customer.

Q. Okay. So let's just be clear. Where Lehman was doing business on a foreign exchange through a broker -- a foreign broker, it dealt with that broker just like it would deal with an exchange? It would post margin, it would have an account with that broker, and that broker would then deal with the exchange?

A. Yes.

Q. And it's your understanding that in that case, as long as Barclays stepped in and took over complete responsibility for Lehman's accounts with that broker, then Barclays would be entitled to the margin that Lehman had at that broker?

A. In those accounts, yes.
Q. And where was Lehman was dealing with exchanges, then whatever margin Lehman had at those exchanges, Barclays would get as long as it took on responsibility for the Lehman accounts at those exchanges?
A. That's my understanding.
Q. Now, are you aware, sir, that under the asset purchase agreement in this case, Barclays did not take on any responsibility for any Lehman accounts at any exchanges? Are you aware of that, sir?
A. My understanding was that in -- that the entire deal involved the taking on of all of the positions, so that is not my understanding.
Q. Did anyone tell you that your understanding was not correct?
A. No.
Q. Did anyone tell you that when Barclays signed the asset purchase agreement, it did not take on responsibility for any Lehman accounts at any exchange or at any foreign broker?
A. Whether or not the -- my understanding was that the professionals who ran the futures business for Barclays were attempting to in fact -- and to my -- I thought that they in fact had taken over or attempted to take over responsibility for those positions and those accounts.
Q. So I take it nobody told you that when Barclays signed the

asset purchase agreement, it did not take on responsibility for any Lehman account at any exchange or foreign broker. No one has told you that?

A. No.

Q. Has anyone told you that when Barclays signed the asset purchase agreement, it insisted on an express term that gave it the right to reject any contract that Lehman had, including any contract with any exchange?

A. That's not my understanding, no.

Q. Are you aware that Barclays declined to take responsibility for the Lehman accounts at the Depository Trust Clearing Corporation?

A. Yes.

Q. Are you aware that Barclays refused to take responsibility for any customer accounts that were in the name of Lehman affiliates?

A. I'm not aware of which customers -- of all of the customers. I'm generally aware that there were certain customers that they did not take responsibility for. But I am certainly not surprised to hear you say that if there was a customer of a foreign affiliate, it would be, particularly in London, difficult to take "responsibility" for those customers. So --

Q. Well, has anyone told you, sir, that the deal documents that you testified about earlier, providing for the transfer of

customer accounts to Barclays, that in those deal documents, Barclays specifically insisted on an exception for all Lehman affiliates?

A. I'm -- I didn't look at those documents, so I'm not aware of that. But I'm not surprised.

Q. Sir, I want to ask you some questions about the general history of this transaction. Are you familiar with the terminology "Lehman I", "Lehman II" and "Lehman III"?

A. No.

Q. Now, did you review the deposition or trial testimony of John Varley?

A. John Varley?

Q. Yes.

A. No.

Q. How about Bob Diamond?

A. Yes.

Q. I'll represent to you, sir, that what I'm talking about when I say "Lehman III", is the actual transaction that closed on Monday, September 22, 2008, the transaction that brings us here today.

A. Yes.

Q. That's what we are referring to as Lehman III, okay?

A. Okay.

Q. And we'll get to that. But first I want to ask you about two transactions prior to that, Lehman I and Lehman II. And

Lehman I, sir, is a transaction that was originally contemplated the weekend prior to September 15, when Lehman filed bankruptcy, in which Barclays contemplated acquiring the global Lehman business, including the parent company, Lehman Brothers Holdings Inc. Okay? That's what we're going to refer to as "Lehman I". Is that okay?

A. Okay.

Q. Now, sir, did you do any analysis of that transaction, Lehman I?

A. No.

Q. So you've no basis for any opinion with respect to Lehman I?

A. No.

Q. Okay. Lehman II, sir, is the transaction that the parties entered into in signing the asset purchase agreement which is dated as of Tuesday, September 16, 2008. And it contemplated the acquisition by Barclays of Lehman's North American brokerage business, including the investment banking business and all the capital markets businesses. Okay? That's what I'm going to refer to as "Lehman II", okay?

A. Okay.

Q. And that's the transaction that included some seventy billion dollars of long trading assets and some sixty-nine billion dollars of short trading liabilities. Okay?

A. Okay.

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Q. Sir, have you -- you can't give us any opinion with respect to that overall transaction that we refer to as Lehman II, right?

A. Other than that -- I've always considered that asset purchase agreement as part of the transaction that ultimately resulted here. But if you want to divide it to some -- I'm anxious to hear how you describe Lehman III.

Q. Well, just pausing on Lehman II for a second. You do, in your report, address the acquisitions of the exchange-traded derivatives business, right?

A. Yes.

Q. And that was a piece of Lehman II, right? The asset purchase agreement --

A. Yes.

Q. -- dealt with the acquisition of the exchange-traded derivatives business, right?

A. Yes.

Q. But your report does not deal at all with the equities business that was purchased as part of Lehman II?

A. Um --

Q. You have no opinions in your report addressing the acquisition of the equities business?

A. Not directly. I mean, except insofar, I believe, as I discussed in my report the fact that with regard to the derivatives listed in the U.S. markets that reflected positions

in equities securities, that some of those positions existed because they were engaged in by the various elements of Lehman's equities and market-making businesses.

Q. And you've no opinions on Lehman II other than that reference?

A. I -- my opinions are contained in the report. So you'd have to be more specific. Opinion about what?

Q. You haven't done any analysis on the equities ac -- the long trading assets, the equities positions, that part of the seventy billion dollars in trading assets that were acquired by Barclays in the APA?

A. Only to the extent that I was trying to form an understanding that at that time, in connection with that transaction, it was intended that the whole book of long and short positions would somehow move over to Barclays. I have my own view about whether, even on that Tuesday or Wednesday, that was possible. But it wasn't necessary for and I didn't express it in my formal opinion.

Q. But beyond that, you haven't done any analysis of the risks or opportunities in that acquisition of that equities business?

A. In the broadest possible sense of opportunities? What do you mean by that? I'm just not following.

Q. You haven't done any analysis in your report or elsewhere about the risks or opportunities that Barclays contemplated,

specifically with respect to the equities piece of Lehman II?

A. No, I haven't -- the only commercial aspect of this transaction that I have rendered an opinion about is that which relates to the assets and liabilities associated with the equities derivatives. To the extent that they included equity securities or intended to include equity securities as part of that business, my conclusion was that in the event, those offsets that might have reduced the risk weren't in place.

Q. And that's my point, sir. Beyond your focus on the exchange-traded derivatives piece of Lehman II, you didn't investigate or do any analysis of any other pieces such as the compensation liabilities or the cure liabilities or the purchase price or the asset-backed securities or the other long equity positions or the corporate debt or any of the other pieces of the Lehman II transaction?

A. An analysis? No.

Q. And you have no basis for any opinion with respect to that overall transaction of Lehman II, right?

A. No.

Q. Now, let's talk about Lehman III. And as I say, that's the actual transaction that closed on the Monday morning. Again, you focused on the exchange-traded derivatives piece of the transaction, right?

A. Yes, primarily.

Q. And again, you didn't do any analysis of the forty-seven

billion dollars of long positions that were acquired by Barclays in connection with that transaction?
A. No.
Q. And again, you didn't do any analysis of the purchase price or the compensation liabilities or the contract cure liabilities, that were other pieces of that overall transaction?
A. That's right.
Q. And you have -- you were asked to focus on the exchange-traded derivatives piece of the transaction, right?
A. Yes.
Q. And you've limited your opinions to the exchange-traded piece of the transaction, right?
A. Yes.
Q. But in fact, sir, that wasn't the deal. This was not the sale of a standalone exchange-traded derivatives business, was it?
A. I agree.
Q. As you pointed out earlier, this exchange-traded derivatives business was an integral part of the inventory and the business -- the other businesses that Barclays was acquiring?
A. Yes.
Q. Isn't that right?
A. Yes.

Q. In fact, you can't think of any reason why Barclays would want to buy the exchange-traded derivatives business, other than the fact that it was not only ancillary, but it was integral to the other businesses that Barclays was acquiring?

A. I generally agree with that statement. That in -- and as I testified before when we were talking about an asset transfer agreement involving an exchange-traded derivatives business, I said I thought that would be quite unusual if we were -- unless we were talking about an FCM business. So I agree with you that the transaction makes sense assuming that you are acquiring all of the businesses that are ancillary to that. Although there is an aspect of that business which is self-generating for profits; that's the brokerage piece of it. The FCM customer side of the businesses can be kind of separated out. You incur a P&L. It has a separate P&L and so forth.

So there's two pieces of the -- generally two pieces of the -- in this case, three pieces of the equities -- of the exchange-traded derivatives business: the business you were doing for customers as a broker; the business that you were doing kind of in the capital markets area, facilitating customer business, and being willing to take on risk in a market-making capacity; and finally, accommodating the proprietary trading and clearing of those positions for whatever the businesses are.

And so, I mean, that would be my -- the way I looked at

this overall transaction. And I think that's what I testified to.

Q. In fact, to be an intermediary in the capital markets business, Barclays had to have -- it needed the exchange-traded derivatives business?

A. Yes. Well, and so did Lehman. I mean, Lehman needed it. And Barclays was, to some extent, already in that business, but not as heavily in the -- there was evidence that they weren't as heavily in the equities market and they were looking to get into that market.

Q. So I'm not going to ask you any questions today, sir, on the subject of any acquisition of a standalone exchange-traded derivatives business. All of my questions are going to relate to the overall transaction, and specifically to the overall transaction that I've referred to as Lehman II, which is the asset purchase agreement that's dated as of the Tuesday, September 16, 2008.

A. Oh, I was anxious to hear you describe Lehman III. Are you going to keep me in suspense?

Q. Well, I thought I had described Lehman III as the transaction that actually closed on September 22.

A. Okay, thank you.

Q. Did you follow that?

A. I do now.

Q. Okay. And focusing now, sir, on the asset purchase

agreement, which you understand was earlier in the week, okay? That was on the -- that's as of the Tuesday, right? You understand Lehman III is the transaction that closed on the Monday, but the asset purchase agreement that we're talking about now, Lehman II, is the agreement that the parties initially entered into on the Tuesday, right?

A. Yes.

Q. Okay. Just as a general matter, you refer to hedging quite a bit in your direct testimony. And when you spoke about hedging, you were talking about hedging as covering risk, right?

A. Yes.

Q. And exchange-traded derivatives can be used to hedge, can they not?

A. Yes.

Q. So exchange-traded derivatives can be very risky things, but they can actually be used in the right hands to manage risk, to decrease risk, right?

A. Yes. The converse is also true. So for example, I believe I described the -- that one of the businesses that Lehman was engaged in was actually market making in options. And if you were facilitating option transactions, what you would do is you would engage in hedging the option risk by going long or short in the equity market or futures. So there would be different ways to hedge that risk.

But it works both ways. You have positions in the cash market you can hedge with options. You have positions in options you can cash in the cash market.

Q. As a general matter, sir, it's true, is it not, that Lehman engaged in various hedging strategies using exchange-traded derivatives?

A. Yes.

Q. Did so for years?

A. Yes.

Q. And at the time of Lehman II, of the asset purchase agreement, you don't know to what extent Lehman was using its exchange-traded derivatives as hedges?

A. To the extent to which it did? No.

Q. But it is fair to say that to the extent that Lehman was using exchange-traded derivatives to hedge other positions in its inventory, Barclays needed those hedges, right?

A. Having those hedges would reduce its risk in the overall portfolio of businesses that it was taking on. But the -- it wouldn't eliminate the risk. And in this case, it would be, you know, very difficult to quantify that risk. But the essential point is that the risk profile of the business would be different if you were looking at the entire book of business, and you could assure or have reasonable assurance that, in fact, you could wind up transferring that business.

My point was that any reasonable party under -- you would

have to have, I think, been highly optimistic to the point of irrationality to think that there would be -- that it would be possible in that week, under those circumstances, with the rapidity with which this deal had to be closed, that you could effect the transaction as it was contemplated of seventy billion of long positions and seventy billion of short positions moving over.

I alluded to this in my testimony. But it was -- just for the benefit for the Court, a short position in an equity security is covered by borrowing the stock in the open market and delivering that stock to the buyer. You get cash for that and you use that as collateral for your short position. So a short position is a series of obligations with numerous -- potentially hundreds of counterparties from whom you're borrowing the stock. To transfer the liabilities on the short positions, somehow would -- I mean, it's just inconceivable that that could have been done in connection with this transaction that was contemplated by the parties; because everyone would have had to accept Barclays as the counterparty to that stock loan. And they weren't even in the business in that big a deal.

Very cumbersome to do. As I said before, you know, it took us weeks to get it done in novation of the forward contracts in the -- in the bankruptcy of Drexel. So, you know, I know what -- I read the agreement. I know what it says. I

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do have a view about what any reasonable -- what a reasonable person familiar with how this business actually worked, how much of that could be accomplished as the parties were hoping to accomplish it within one week's time.

MR. MAGUIRE: Move to strike the witness' answer as nonresponsive.

THE COURT: I'm not going to strike it, but I'm going to disregard it.

Q. Sir, my question is simply, to the extent that Lehman's exchange-traded derivatives hedged other positions in Lehman's inventory, and Barclays didn't want to go naked or speculative with respect to those positions, it needed those hedges, it needed to acquire those exchange-traded derivatives?

A. It would help, yes.

Q. And if it didn't get those exchange-traded derivatives, and it wanted a hedge, then Barclays would have had to go out and replace those exchange-traded derivatives, right, with another hedge?

A. If it got all of the cash positions?

Q. If Barclays took Lehman's inventory without the hedging exchange-traded derivatives, then Barclays would have to replace those exchange-traded derivatives by going out and getting other hedges?

A. I disagree with that statement.

Q. Well, if --

A. I absolutely disagree with that statement. If Barc -- because if I understand you correctly, what you're positing for me is that they're going to, in fact, take the book of equity positions, long and short, and they're going to look at that set of exposures, and they're going to conclude that the entire portfolio of equity exchange-traded derivatives that they would be taking on would hedge that book. That's just factually in --

Q. No. Let me clear up the question. I'm asking you, to the extent that Barclays is taking an inventory position, and to the extent that position is hedged by an exchange-traded derivative, and assuming Barclays doesn't want to go unhedged, then Barclays needs to take the hedging exchange-traded derivative, right?

A. If, if, if. Yes.

Q. And if it doesn't take the exchange-traded derivative, it would have to replace it or else go unhedged?

A. Correct.

Q. So with or without any margin, Barclays needed the exchange-traded derivatives that hedged other positions in Lehman's book. Isn't that correct?

A. No. Look, they didn't need them. It was a risk mitigant to a portion of their book, potentially, if they had them. However, my experience in the manner in which equity portfolios -- equity trading portfolios are hedged, is that you

first look to the long and short positions of the portfolio itself to net out what is the overall equity risk, and then you may try futures contracts to mitigate that risk.

The futures contracts would be those traded on the Chicago Mercantile Exchange, S&P futures, and similar index-related futures. Those positions, if they ever had them, had been liquidated by the CME on Wednesday. So the -- in a way, the overall profile of risk, at least on the Wednesday, had been changed, to the extent that any S&P positions -- futures positions had been wiped out.

So I don't accept as a premise that there is somehow a one-to-one relationship between their entire equity book and options, because I don’t accept that in each and every case, that options were either the only or even the preferred method of hedging the equity book.

Q. And do you understand, I'm not asking you about a one-to-one, and I'm not asking you about the entire book. I'm asking you very specifically about the exchange-traded derivatives that were hedging other positions in Lehman's inventory. Those exchange-traded derivatives. Do you understand --

A. Yes.

Q. -- that's what I'm asking you about?

A. Okay.

Q. And to the extent that Barclays did not want to go unhedged -- did not want to take a speculative flier on

billions of dollars in other positions in their book, to the extent that those exchange-traded derivatives hedged other positions in Lehman's book, Barclays needed those derivatives. You accept that, do you not?
A. It would help to mitigate their risk, yes, to the extent.
Q. Now, you have done no analysis of the extent to which Lehman's exchange-traded derivatives hedged other positions in the Lehman inventory. Isn't that right?
A. I have not. And to my understanding, neither was Barclays able to engage in such an exercise.
Q. You do admit, sir, that Lehman's portfolio of equity securities included many positions that were hedged by Lehman's exchange-traded derivatives?
A. I accept as a -- I have not looked to specific correlated transactions between a hypothetical equity book and the particular options, because that information was not made available to me. It would have been that information which was available to the parties on the Monday or Tuesday. Because by Friday, everything had changed.
Q. Now, sir, in tab 1 of your book, if you'd go to your report at page 27, and look, sir, at paragraph 63.
MR. MAGUIRE: Maybe we can put it up?
Q. There you note, sir, that, "Subsequent to the signing of the APA the exchange-traded derivatives assets and liabilities of LBI were constantly changing, as was the portfolio of equity

securities that Barclays had originally intended to acquire, many of which hedged or were hedged by the exchange-traded derivatives."

You did say that in your report, did you not, sir?

A. Yes. Right.

Q. You don't deny that today, do you?

A. No.

Q. And you agree, sir, that where exchange-traded derivatives are coming with a broker-dealer's inventory, a buyer may not insist on acquiring margin, and may be willing to use the buyer's own resources. Isn't that a fact, sir?

A. I explained that in the context of a transaction between two solvent parties where the parties had the ability to engage in a complete assessment of what was intended to be exchanged and plenty of time to do due diligence, that that might be an aspect of the negotiation. You're absolutely right.

Q. And that's at page 45 of your report, right, sir? At paragraph 94? That's where you have the first sentence, I think we talked a little bit about before, with respect to posted collateral, "Under normal circumstances a buyer and a seller would have reached an agreement about whether the transfer of exchange-traded derivatives would come with or without the related collateral."

A. Correct.

Q. And you go on to say, "The outcome would depend in part on

how the margin requirements were met. For example, cash collateral versus letters of credit." Then you say, "This determination would be made in the context of accurate information about the related inventory positions being acquired, and to some extent, would depend on the motivations of the parties with respect to the market in which the exchange-traded derivatives traded." Right? And you specifically emphasize the motivations of the parties, right?
A. Yes.
Q. Then you go on to say, "For example, if exchange-traded derivatives positions in a particular market were coming together with inventory to be actively managed by the buyer, the buyer might be less insistent upon acquiring the collateral posted and would be more willing to use its own resources." Right, sir?
A. Yes.
Q. And here, you do agree, do you not, sir, that the exchange-traded derivatives, that whole business and the derivatives themselves, as of the date of the asset purchase agreement, that we have been referring to as Lehman II, that was integral to the overall inventory of Lehman?
A. I expressed my opinion that, you know, the document says what it says. I've indicated to you what I thought any reasonable party would have assumed would be in fact possible or likely to be accomplished, even on the Tuesday.

Q. Now, sir, after the Tuesday, after the Wednesday -- the Wednesday and later, circumstances changed, did they not?

A. They did.

Q. And you point that out in your report. You point out the changes that happened after the parties had executed the asset purchase agreement, right?

A. Yes.

Q. And you do that at page 48 in paragraph 100 of your report. There you say, in paragraph 100, "In short, the circumstances as they existed by the end of the week of September 15, made it not just reasonable, but imperative that Barclays acquire all of the collateral held in respect of Lehman's various exchange-traded derivative accounts," right?

A. Yes.

Q. And you were very specific there that what you're referring to are the circumstances as they existed by the end of the week?

A. Yes.

Q. And the circumstances that made this imperative, not just reasonable, but imperative for Barclays, are all circumstances that happened by the end of the week and that you survey in paragraph 98 and 99 of your report, right?

A. Right.

Q. Right, sir?

A. Yes.

Q. In paragraph 98 you say that, "The facts on the ground changed as the week of September 15 progressed," right?

A. Yes.

Q. And those facts, those changes, made the whole acquisition of the exchange-traded derivatives piece, as you understood it, to be much riskier than it was at the beginning of the week.

A. Yes. And made it riskier in two senses. It made it much riskier for the estate and it certainly made it -- it certainly changed the characteristic, to some extent, for Barclays. However, in my view, as I was telling you before, I don't think that it changed what would have been Barclays' expectation, and let me step back, because I think I said this on my direct, is that the general expectation of the parties would be that collateral would move in the circumstances where you were transferring a business of the sort that was described in the APA. That would be the first, so that you would have -- have to -- so, my opinion, as having been in this business for, I hate to say it, coming up to almost thirty years now, is that that would be the expectation and that you would have to take special care to change that expectation and to carve it out, and under the circumstances of this transaction it would have been very difficult. That's my opinion.

So, yes, the facts changed, so whatever, and let me make it clear. They changed the risk profile, although not necessarily the motivations of the parties to get this deal

done, but it changed the risk profile and it changed it more for the estate than it did for Barclays. It did change it, made it worse for Barclays, but it made it really critical for the estate.

Q. And the specific facts changed that made this imperative and not just reasonable by the end of the week. Those specific facts you point to in paragraph 99 as the self-help seizures that occurred later in the week.

A. One of the factors, yes.

Q. Now, you'd agree with me that the critical moment that we need to focus on here in looking at the motivations of the parties is what they knew at the time that they made the decision, at the time that Barclays made the decision to acquire the exchange-traded derivatives, right? It's the moment of decision. That's when we want to focus what was known, right? Not what happened two days or ten days or months later?

A. Well, I believe the parties certainly have the, you know, ability, based on changes in circumstances, to decide that the initial transaction as conceived will be closed with a different mechanism, which is what I assume you were getting to in deciding on Lehman 3. But, in general, yes, it is my understanding that the deal was articulated in the APA. I understand the APA was amended, but, essentially, in the APA, for purposes of the discussion we're having, and, as I

understand it, that essential business deal didn't change. That these businesses would be transferred, I suppose, was a generally accepted caveat that everybody had, to the extent they could be, at the closing to Barclays and that a bunch of assets would hopefully go over, and to the extent that there were risks associated in the listed derivatives book those would go over too.

Q. My only point is that when we look to see what had made sense for Barclays to do on Tuesday we have to look at the facts on the ground on Tuesday, right?

A. As would be -- as they would be interpreted by, in my view, a rational purchaser and seller, yes.

Q. And the parties made the decision that Barclays would acquire the exchange-traded derivatives' position in the asset purchase agreement earlier in the week.

A. Yes.

Q. Isn't that right?

A. Correct.

Q. And that was before the facts on the ground changed, right? That was before the self-help seizures that you referred to in paragraph 99 of your report.

A. Just before, but under circumstances where, in my view, they could be expected, because even on the Tuesday, as I recall the record, there had already been discussions by the CME that if looking for protection, and, in fact, Barclays had

sent people over to look at the acquisition of taking over or guaranteeing some portion of Lehman's exposures on the Sunday, so the -- I don't think that we can look at Tuesday. The bankruptcy had already been filed. Lehman was in distress. A bunch of lawyers are given the task of articulating what they are told is, quote, "the deal", and they do their best to accomplish that in a very short period of time. I think they did the best they could under the circumstances, and I think that although it's a lot of fun to look in 20/20 hindsight about what could have happened, I think we need to be aware, as the parties in this room are more aware than I, of the facts and circumstances as they were on the ground on Monday and Tuesday, which were bad enough.

Q. Now, sir, you said the essential business deal did not change. Let me just ask you to clarify one or two points on that. Obviously the deal changed in a very drastic way, and you acknowledge it in your report, from the Tuesday to the Friday. I mean, for example, seventy billion dollars of trading assets became forty-seven billion dollars of trading assets. That's a pretty dramatic change, is it not?

A. Yes.

Q. So when you said the essential business deal did not change what you were referring to was the fact that Barclays was acquiring the exchange-traded derivatives business. That did not change.

A. Well, no, I meant more than that. I meant that the intent of the parties to transfer the, all of the essential elements of Lehman's U.S. broker-dealer and capital markets business and FCM business and have Barclays come in and take over, that meant the people, that meant the, all of the other things that were included in the deal. We're focusing here on the ETD portion of the business, but when I say that the deal, as a transfer of the business and all of the assets necessary to conduct that business, I'm not aware that that essential part of the deal changed.

Q. Well, let me ask you specifically with respect to the exchange-traded derivatives. The decision, Barclays' decision to acquire the exchange-traded derivatives, that was made early in the week in the APA, right?

A. Yes.

Q. And that was not revisited. That never came up again after that.

A. Correct.

Q. Now, you're aware that Lehman representatives, Lehman executives, believed that there was no margin in this deal.

A. I believe that -- I've read testimony of two Lehman folks on this subject. One was Bart McDade, who testified, I think, fairly recently that he didn't think margin was included in the deal, and I read the testimony of another executive named Seery, who thought that it was. So --

Q. When you say you read the testimony recently you're referring to the trial testimony of Mr. McDade?
A. Yes.
Q. Why don't we ask you to turn to tab 3 of your binder, and we'll show you there the testimony for Mr. McDade on April 26th here at page 234 of the transcript, starting at line 20.
A. Okay.
Q. And that's where Mr. McDade was asked:
"Q. Can you please tell the Court whether Lehman's margin assets were included in the sale?
"A. They were not intended to be included in the transaction.
"Q. Did you ever authorize any agreement with anyone at Barclays to include any Lehman cash margin in the sale?
"A. No, I do not."
Q. Is that the testimony that you are referring to, sir?
A. Yes.
Q. And that testimony did not affect your opinion in any way. Is that right, sir?
A. Insofar as it -- my understanding was that Mr. McDade wasn't -- was responsible at the highest level of Lehman for getting this deal done and that others were involved in the actual negotiation with both parties. So I do not, obviously, know what other indications or instructions may have been communicated down to actually reflect the agreement on the ground. When there is testimony of other people saying that

they understood that the collateral was to move in the deal, and that, certainly, that was the view on the Barclays side of the transaction, both at senior levels and at the levels of the lawyers who were instructed to carry this out.

Q. Did you consider Mr. McDade's testimony to be inconsistent with your opinion?

A. Yes.

Q. Did you review the testimony that Barclays presented of an executive by the name of Mr. Shapiro?

A. I don't recall that testimony.

Q. If you turn, sir, to tab 4 of your binder you'll see the trial transcript from August 23 here, and if you turn to page 25 you'll see where Mr. Shapiro is asked by, I believe, Barclays' counsel, starting at line 21:

"Q. Now, who were the lead negotiators for Lehman in this process?

"A. Bart McDade, our president, was the guy who really led the overall negotiations. No decision got made without basically Bart being involved in that decision."

Q. Did you consider, sir, or do you consider that testimony, presented by Barclays to this Court, to be inconsistent with your opinion?

A. You know, I'd be careful of -- I don't like the word inconsistent. I mean the testimony stands for itself, and I don't know the context of what the witness here, who I don't

know who he is or what his position is and what aspects of the transaction he happened to be working on, but it is -- let's put it this way. It is inconsistent with the manner in which all of both the Lehman, the trustees, and, certainly, the Barclays' lawyers and business people down the ranks were acting in order to both articulate and close the transaction. It is inconsistent with what, in fact, happened. If Mr. McDade was emphatic about the collateral not moving then there would have been an expected set of actions to have occurred to make sure that that did not happen. And it is completely inconsistent with authorizing representatives of Lehman to execute agreements that were totally inconsistent with the idea that the collateral is not being transferred. So I don't know how to explain it other than in the event nobody acted as though this were the deal that the parties had, in fact, agreed to.

Q. Did you check that? Did you do anything to see if Lehman informed Barclays that there was no margin in this deal?

A. Checked? I've read trial testimony by Mr. Seery, who, as I understand it, was a Lehman executive who said that he thought that the collateral was to be included in the transaction, and, as I said, I was focusing on also what happened at the hearing before Judge Peck and the documents that were executed immediately thereafter to accomplish the transaction, all of which were consistent with including, you

know, going to the CFTC. This was not done in a vacuum. My understanding is that the team negotiating for Lehman was fully informed of these actions, and that no one at any time, to my knowledge, had said why are you doing that. We need to make sure that, you know, we don't transfer the margin. What are they doing to make sure that they're collateralizing these accounts? How are -- we can't less this happen. I was not aware of any such communication. If you bring it to my attention, fine, but I am not aware of any such communication.

Q. Would it affect your opinion, sir, if Lehman had provided Barclays with information showing that there was no margin being transferred here?

A. There would have had to have been a reaction to that. That is, the lawyers themselves would have had to do something consistent with that instruction, because, after all, the lawyers are the agents of the parties when you're engaging in a, you know, a transaction of this sort, you know, the documentation and execution of the deal has to, you know, carry out what people feel was intended in the transaction document.

Q. We'll get to the lawyers, but how about the principals, the decision makers? Would it affect your opinion if the decision makers at Lehman provided Barclays with information showing that there was no margin in the deal? Would that affect your opinion?

A. That would depend on what the -- well, look, my opinion is

what rational, what I believe that Barclays is, as a party, would have rationally done here, and that it was in the best interests of Lehman to do exactly what happened. That's my opinion. So if -- why don't you show me something, because I -- it's just an abstract hypothetical question right now. Would it affect my opinion? The answer is I don't know.

Q. Happy to do that, sir. You'd agree with me that cash is a financial asset, is it not?

A. Yes.

Q. And cash equivalents are financial assets, are they not?

A. Yes.

Q. Margin is a financial asset, is it not?

A. Margin is an encumbered asset. I -- you're asking -- I don't know whether you're asking me in the sense of an accounting term or whatever, but I would look at collateral as a, in a different category than I would cash that you have in a bank account that you can draw on freely. Once you put collateral up at the clearinghouse you cannot use it. It's there for one purpose only, and that's --

Q. Whether you can use it or whether you can't use it, you own it. It's an asset, is it not?

A. Well, the practice -- it's interesting. The practice in the industry is that a lot of the assets that are actually deployed in margin accounts are used with part of the treasury operation in financing the business overall. So whether it's

cash in the sense -- whether the actual assets used have been traced to, you know, sort of, free funds on the -- on a balance sheet or traced to some borrowing, since most treasury securities are not taken out of the inventory -- that are used in margin are not necessarily taken out of the inventory of the firm as collateral but are usually reversed in as part of the treasury operation, are they, quote, "theirs" at the time? Well, yeah, but they're also theirs in the sense that there's an obligation, potentially, to give them back. So the composition of treasuries that may be used to provide collateral can be -- could be constantly changing because of the rates in the repo market. So --

Q. When you were at Goldman, sir?

A. Yes.

Q. Did you consider that Goldman owned the margin assets that it had at the exchanges?

A. I considered the manner of funding just the way I described it, that the -- that those assets which we -- that we claimed on the balance sheet as assets were paired off against liabilities, and, so, the difference would be, you know, the equity in the business and --

Q. That's what a balance sheet is.

A. That's what a balance sheet is.

Q. That's where you put the assets on one side and the liabilities on the other, right?

A. Okay.
Q. And margin is an asset, right?
A. To the extent that -- well, look, the margin here consists of a letter of credit. I wouldn't consider that an asset.
Q. The cash --
A. To the extent that you --
Q. -- them to the asset.
A. -- cash or margin you may be booking that as an asset on your balance sheet.
Q. Maybe you can look, sir, at tab 5. That's a balance sheet that Lehman provided. It's Movants' Exhibit 2.

MS. BLOOMER: Your Honor, I object to Mr. Maguire's characterization of this as a Lehman balance sheet. I don't think there's any evidence in the record to support that that's what this document actually is.

THE COURT: Well, it's -- the objection is overruled. It's a list of assets and liabilities. We've seen this document countless times in the case. To the extent there's a characterization in the question that's overly broad, the witness is an expert and can certainly deal with the question. It's simply presenting a document, and I'm accepting it for what it is, which is Movants' Trial Exhibit 2, initialed in the upper right-hand corner.

Q. Sir, I'll ask you for your characterization. You understand that this is a balance sheet. Isn't that right?

That Lehman provided to Barclays.
A. Well, look, I'm, obviously, I will accept your characterization of the document. It is what it is. It's a list of assets and liabilities. I have no reason to believe that it -- to know anything about its accuracy or anything else, but I -- it is what it is.
Q. Sir, if you turn to your transcript, which, I believe, is in the back of your binder, your deposition transcript, and you turn to page 63. You'll see at line 14 you were asked the following --
A. What page?
Q. I'm sorry. Page 63.
A. Yeah, but what page of the --
Q. Of the deposition transcript?
A. Yeah, I'm on page 3 of that exhibit, and then there are pages 246, 47. So which --
Q. I'm sorry. This should be the tab all the way at the back. You should have a full copy of your deposition transcript there now.
A. I see it.
Q. And do you have page 63?
A. I do.
Q. Is that included there?
A. And this is divided into four quadrants.
Q. Yes. You went to the upper right-hand quadrant.

A. Okay. What you -- what is listed as page 247. Okay. And line --

Q. And starting at line 14. You can also see it on the screen if that's easier. And there you're asked the question: "Q. Mr. Leitner, I'm handing you what" --

A. Sorry. I'm -- where --

THE COURT: It's page 17 on the bottom and it's --

THE WITNESS: Page 17 on the bottom. Thank you, Judge. Okay. Thank you. Now, I got it.

Q. Okay. Are you on line 14?

A. Yes.

"Q. Mr. Leitner, I'm handing you what has previously been marked as Exhibit 19 of these depositions."

Q. I'll represent to you, sir, that that is Movants' Exhibit 2.

"Q. You've seen that document before, haven't you, sir?

"A. It looks familiar.

"Q. In fact, you include it in the list of documents that you reviewed to prepare for your report, correct?

"A. Yes.

"Q. Can you tell me what you understand that to be?

"A. It's one of the balance sheet snapshots that the parties were dealing with. I believe it was prepared by Lehman for Barclays."

Q. You were asked those questions, and you gave those

answers, right, sir?
A. Yes.
Q. Now, you're aware, sir, that there is, if we go back to Movants' Exhibit 2, there's no margin in that balance sheet.
A. It -- there's no line saying margin, correct.
Q. No margin anywhere there.
A. There's --
Q. Let me put it this way, sir. Have you done anything to find out whether there's any margin, any of the margin assets at any of the exchanges or with any of the foreign brokers is reflected on that balance sheet?
A. Well, we --
Q. Did you do anything to check that fact?
A. Now, with all due respect, you're asking a question which is completely in opposite to, which -- I would have thought the correct question is do you know where those assets are? And to the extent I accept your proposition that margin consists of assets, then the question is where are the assets being deployed? The assets happen to be -- being deployed as collateral to support the equity -- sorry, the exchange-traded derivative business, and they are, therefore, assets that are, in fact, used in that business, and there are assets intended to be transferred as part of the overall business that Barclays is acquiring. So, yes, this is a balance sheet of assets. It doesn't tell me where they are, what they're being used for, or

anything else. And, so, of course there's no line for margin, because some of the assets are being deployed to support that part of the business, just as part of the liabilities are supporting the long equity positions. Somewhere in there is a repo.

Q. So if I understand you, sir, if there's no margin anywhere on this balance sheet, and if Barclays understood there's no margin anywhere on this balance sheet that would not affect your opinion in this matter?

A. Right, because it doesn't tell me where the -- that's correct. It doesn't --

Q. And you did not ask Barclays to explain what they understood this balance sheet meant.

A. No, I did not.

Q. And if Lehman gave Barclays a balance sheet as of the signing of the asset purchase agreement, and that balance sheet did not contain any margin, would you consider that to be consistent with Mr. McDade's testimony that there was no margin in this deal? Would you consider that to be consistent?

A. Margin is not a category of an asset. Margin is a term of art to describe collateral that is assets of the party posting that collateral but happens to be put in a particular case. It's a location issue not a balance sheet issue. So of course there's no margin on the balance sheet, because it would be a portion of cash, government securities or whatever other assets

the particular clearinghouse would accept.
Q. And, so, that would not, the fact that there's no margin on the Lehman balance sheet would not affect your opinion?
A. Correct.
Q. And the fact that Barclays did not find out where any of this margin was prior to signing the asset purchase agreement does not affect your opinion?
A. My opinion is that whatever margin was there was -- were assets used to support the businesses that were being transferred. Barclays would have expected to get them and that the parties acted consistently with that expectation.
Q. Now, you do agree, sir, it would have been prudent for Barclays to get a report of all of the exchange-traded derivatives that it was taking on here prior to signing the asset purchase agreement.
A. Look, I think the -- in any transaction, any acquisition transaction, as anyone knows who's been involved in it, you try to do as much due diligence as possible before you enter into an agreement and in a major transaction. As an element of that due diligence it would have been great if the parties had had the opportunity to look at and study all of the aspects of the businesses being acquired. My understanding is that Barclays had, indeed, done some preliminary analysis of Lehman even prior to that week, and, certainly, over the weekend had attempted to do some investigation with regard to helping

support the futures part of the business. But, so would it have been appropriate in a normal transaction to have done that thing? Absolutely. But this was not a normal transaction, and I think the parties were entering into this transaction in good faith to take -- take Lehman out of -- take Lehman out of it and put Barclays in the position for the benefit of the marketplace and for the commercial interests of the parties.
Q. OCC can give you a report right away on what the positions are, right? They've got systems. They keep track of that, not only at the end of the day but intraday. Isn't that right.
A. Yes.
Q. They watch this stuff very carefully. You want to know what the positions are at the OCC, they can give it to you, right?
A. Well, they'll give it to the clearing member, yes.
Q. And with all of the risks you told us about, clearing risks, the market risks, the funding risks, you still don't think it was necessary for Barclays to get that report and see what positions it was taking over. You don't think that was necessary.
A. As I understand it, I -- was it necessary? No, it wasn't necessary. Would it have been helpful for the parties to do that? Yes. But, you know, my understanding is that the deployment of personnel at Barclays to begin the detailed investigation of what was involved in the transaction, unlike a

normal transaction, occurred after the signing of this document and not before and depended largely on this global information being provided by Lehman to Barclays. That's my understanding, but I haven't done a complete investigation of all of the, you know, the elements leading up to it.

Q. And the reason it wasn't necessary -- the reason it wasn't necessary for Barclays to actually get a report of all these risky exchange-traded derivatives' positions that it was taking, the reason that wasn't necessary is because Barclays wanted to do the deal. Isn't that right?

A. It was -- it wanted to do the deal where it was assuring itself that it was going to have a risk mitigant against the exposures it was taking.

Q. Barclays could go into this sight unseen, without looking at the exchange-traded derivatives, and you think it wasn't necessary for them to get a report showing those positions, because Barclays was motivated to do the entire transaction. Isn't that right, sir?

A. You're -- I'm sorry. I missed -- your question you're asking me, is it was it necessary?

Q. You say it wasn't necessary for Barclays to see the exchange-traded derivatives' positions it was taking up. Notwithstanding all the risks it wasn't necessary. And the reason it wasn't necessary is because Barclays was motivated to do the entire transaction. Isn't that right?

A. That's a reasonable conclusion. It's not a conclusion that I've reached in any independent way, but it's, I would concur that it's reasonable.

Q. So the bottom line here is that Barclays was willing to take on whatever was in the Lehman portfolio, sight unseen, because it wanted to do the entire transaction. Isn't that right?

A. Yes.

MR. MAGUIRE: If this would be a good time to stop for lunch, Your Honor?

THE COURT: I think it would be. Just a general inquiry as to how much more you expect in terms of time.

MR. MAGUIRE: I would try to do it within about half an hour or so, Your Honor.

THE COURT: Okay. We'll resume at 2 o'clock.

(Recess from 12:34 p.m. until 2:07 p.m.)

THE COURT: Be seated, please. And, Mr. Maguire, please proceed.

RESUMED CROSS-EXAMINATION

BY MR. MAGUIRE:

Q. Sir, in any part of your testimony this morning did you mean to suggest that Lehman was unable to generate a report from its systems that excluded the over-the-counter derivatives?

A. That's my recollection of the testimony that some of the

operations people gave, yes.

Q. Did you check that with the people that you talked to?

A. I actually met with Liz James in connection with, you know, while I was preparing my report and also with some folks who were at Lehman and now at Barclays, and my recollection is that among that group of people were folks who were charged with obtaining this data from our senior people, and that's what they told me.

Q. One of the folks that you met with who was at Lehman and was at Barclays at the time that you met with him was Daniel Dziemian, right?

A. Yes.

Q. Did you check with Mr. Dziemian whether that was, in fact, the case?

A. I would -- I don't recall a specific conversation with him on that.

Q. If you could turn, sir, to tab 7 in your binder. You'll see there is an excerpt from the deposition testimony of Mr. Dziemian. And if I could ask you, sir, to turn to page -- it's page 28 at the very bottom. It should be the last page in that tab. And if you look at the top right quadrant you'll see page 107 of his deposition transcript. And they're starting at line 14. This is from page 107 of Mr. Dziemian's deposition transcript. He's asked the following question:

"Q. Would you have any problem in creating an ADP report and

excluding from that report over-the-counter derivatives?

"UNIDENTIFIED SPEAKER: Objection.

"A. Yes, and the way we would do that is by using an ADP options trade day stock record report, which OTC derivatives would not be included on."

Q. And, then, after a little colloquy, the question starting at the top of page 108 is

"Q. Mr. Dziemian, did you mean to say that you would have a problem in excluding the OTC derivatives or you would not have a problem?

"A. Would not."

Q. Do you see that testimony?

A. Yes, sir.

Q. And you say you did not raise that subject when you spoke with Mr. Dziemian?

A. Well, it was relevant to know what Lehman had and what they thought, and, so, my conversations on this point were mostly with Ms. James, who worked for Barclays.

Q. Did you understand that Mr. Dziemian was, in fact, the person responsible for generating reports concerning the exchange-traded derivatives?

A. He was one of the people who could do that, yes.

Q. All right, sir. Now, you had told us this morning about how facts on the ground changed during the Lehman week. Remember that?

A. I think we were having a colloquy about what my report said, yes.

Q. Are you familiar with what has been referred to in these proceedings as "the Friday asset scramble"? Let me put it more generally for you, sir. Are you aware that on the Thursday night and the Friday morning of the Lehman week, that's Thursday the 18th, that night, and Friday morning, Friday the 19th, Barclays was concerned to find additional assets for this deal?

A. I have seen testimony describing what you've just described.

Q. And are you aware, sir, that one of the top Barclays executives involved in this deal was Stephen King?

A. Yes.

Q. Are you aware, sir, that Mr. King sent an e-mail to Barclays' chief financial officer on Thursday night proposing adding margin in the deal?

A. I don't recall seeing that e-mail.

Q. If you turn, sir, to tab 8 of your binder you'll see Movants' Trial Exhibit 620. Are you with me?

A. I'm sorry. Tab 9?

Q. It should be tab 8.

A. Eight, okay.

Q. And at the bottom right-hand corner you should see a sticker with Movants' Trial Exhibit 620.

A. Yes, I have it.
Q. And if you look at the bottom of that e-mail string you'll see it starts chronologically with Stephen King sending an e-mail to Patrick Clackson on the night of Thursday, September 18. Do you see that?
A. Yes.
Q. And what he says is why don't we add the initial margin on the repos. Do you see that?
A. Yes.
Q. And then he follows up with a correcting e-mail a little bit later in which he says sorry, I meant exchanges and clearinghouses. Do you see that, sir?
A. Yes.
Q. Now, would you agree, sir, that there would be no reason for Barclays to add margin to the deal on Thursday or Friday if it was already in the deal at the beginning of the week?
A. There would be no such reason, and, by the way, I have no information that I recall anywhere about the context of this document or this particular exchange, so --
Q. Did you ask Mr. King about this document when you spoke with him?
A. My understanding from Mr. King was that he understood that the margin for the OTC derivative positions was involved in the deal.
Q. Did you ask Mr. King about this document when you spoke

with him?
A. I didn't personally ask him, no.
Q. Now, sir, I'd like you to assume -- I'd like you to make an assumption -- I'd like you to assume that Barclays agreed to exclude all assets that were related to exchange-traded derivatives in this transaction? Do you understand that assumption?
A. Okay.
Q. Now, if Barclays agreed to exclude all assets that were related to exchange-traded derivatives that would be consistent with a deal that did not include margin. Isn't that right?
A. It would be consistent with a deal other than the one that was here, yes.
Q. You'd agree, sir, that margin is an asset that is related to exchange-traded derivatives?
A. Margin, to the extent that it includes cash or securities, would constitute assets of the clearing entity or of their customers. It would not necessarily be the only margin in the account and would be assets of the -- could be assets of the clearing member. We already discussed that, yes.
Q. So cash and cash equivalents are assets that are related to exchange-traded derivatives.
A. These are assets that are in the account. I'm only quibbling -- I don't mean to quibble with your use of the word related. They are -- I would certainly say that, and I have

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said, in my report, that these are -- that all the collateral were associated with the business. You used the word related to. I think the documents used the term associated with, and I would certainly classify that as associated with the doings in the business.

Q. Are you aware, sir, that the deal documents here contain a term excluding all of Lehman's cash and cash equivalents?

A. I believe there is a clause to that effect in the agreement. I can't remember exactly which one.

Q. And are you aware, sir, that over the closing weekend Barclays proposed making an exception to that cash exclusion?

A. I think the issue of cash, from all I've seen in the record, both in the document and in the reference to cash in the -- during the testimony before the judge, Judge Peck, leading to the signing of his order and in the so-called clarification letter, was, to me, very confusing, because, for one thing, it was inconsistent with the view that encumbered collateral, whether it consisted of cash and cash equivalents, was included in the deal, so I'm not sure exactly what portion of cash was being excluded and where it was.

Q. Did you come to learn in the course of your work on this that Barclays proposed a carve-out, an exception, from the exclusion for all cash and cash equivalents? Did anyone tell you that?

A. I don't know what you're referring to. Are you making a

general statement about drafting of a document?
Q. Yes. Did you either see a document or did anyone tell you that over the course of the Lehman weekend Barclays proposed the proposed language that would have created an exception to the cash exclusion and that that exception specifically addressed Lehman's margin?
A. What I did see was various drafts of a clarification letter. It wasn't always clear to me from the record that I saw who proposed what amendments to that document at various points in time, but at one point there was a paragraph dealing with excluded assets in which there was an exception to the exception to excluded assets, which, frankly, I find very confusing, so if that's the paragraph you're referring to I believe that was an exception to that portion of that very complicated paragraph that dealt with an exclusion to cash. So if that's what you're talking about that's what I saw.
Q. That's exactly what I'm talking about. Very good. Did you ever get to the bottom of all that confusion?
A. Yes. And I believe the attorneys got to the bottom of it too, because, as I understand from the testimony of Mr. Rosen, he had what I would consider an elegant solution about taking that confusing syntax and putting it in a way in that clarification letter that made sense to him and also made sense to me and actually would up using fewer words, which is unusual in these transactions.

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Q. Let's leave aside Mr. Rosen's elegant solution for a moment. Let me ask you, sir, did it come to your attention that Lehman's lawyers at Weil, Gotshal -- Lehman's lawyers at Weil, Gotshal -- that they had deleted all of the language that Barclays had proposed addressing margin?

A. I don't recall the backing-and-forthing (sic) of who was doing what with regard to the draft. I -- whoever signed the final version.

Q. Would you agree with me, sir, that if one side, the buyer, proposes putting margin in the deal, and the other side, the seller, rejects that proposal, would you agree that that raises a real question whether margin is in the deal or is not in the deal?

A. It would, except that here there was also testimony that when Cleary Gottlieb went back to Weil, Gotshal and said why did you take that out or words to that effect, I think Mr. Rosenfeld testified to this, maybe others as well, that they said okay, that's a mistake. Let's fix it. And that's why he fixed it in the final draft that was ultimately signed.

Q. I'm not going to get into who said what to whom, sir. I'm asking you a fundamental question. When that happens, one side proposes adding margin, the other side rejects it, you'd agree the buyer and the seller have to go talk to each other to figure out whether it's in the deal or not and work it out, right?

A. That's a hypothetical but not necessarily a statement of what actually happened here, because I don't know whether it was a fact that Weil, Gotshal took that paragraph out because they disagreed with the proposition that margin was included or simply because they didn't like where it was in that complicated paragraph. So --
Q. But they had to talk to them, right?
A. I assume they were talking, and it led to the final version of that agreement that reinserted in a different place exactly the concept that had been in that complicated paragraph.
Q. If Barclays believed margin was in you have to assume that they went and talked to Weil. Isn't that right? You have to assume they went and talked about it. If margin was so important to Barclays, and they saw that language deleted, you would naturally expect Barclays to go and talk to Weil, Gotshal, right?
A. My understanding is the lawyers were talking to each other, you know, all the time during this very compressed period trying to get the deal done.
Q. So you would expect a rational purchaser to go talk to the seller.
A. But I don't know that they didn't. I mean, somebody had a conversation that led to the -- a final version of the clarification letter as it came out, and in that letter, which

was signed off by all the relevant parties, the issue of collateral in respect of the derivative transactions was put back in. So if there was a -- if one law firm was objecting to the characterization in one draft of the letter there were discussions that led to the final version. There has been testimony, which I can't cite off the top of my head, about that process of going back and forth.

Q. It's not a memory test, sir. I'm not asking you to recall testimony. I'm just asking about your expectation. Your expectation is that a rational purchaser would go and talk to Weil, Gotshal and find out what the reason was why the language was deleted, right?

A. Yes.

Q. And if there was a problem then the principals would be brought in and they would work out whatever the problem was, right?

A. Yes.

Q. And where you have a rational purchaser they'll explain why they need the margin, right? You've told us why Barclays needed the margin, to protect itself, right?

A. That's not the only thing they would say. They would say margins been in the deal from the beginning. Why did you take this out?

Q. I'm sure they would. My only point is you don't say anywhere in your report that Barclays needed this margin to

fatten its profits. Your report simply talks about how Barclays needed this margin to protect itself, right?

A. I say that, but I also say that in the transaction involving the sale of this business it would be, in my view, normal for the margin to be considered part of the assets necessary to operate the business. And, so, whatever was there that the -- that the transferor had chosen to, whatever assets they had chosen to use would move to the acquirer, that that was the essential transaction and remains so throughout. The other issues that I cite in my report were why under the unusual circumstances of this transaction and the -- that no rational purchaser would have done otherwise.

Q. People use margin to protect against downside risk, the risk of loss. Isn't that right?

A. That is its purpose, yes.

Q. It protects market participants like exchanges and broker-dealers against the risk of loss, right?

A. Yes.

Q. And if the market moves against you then the dealer or the exchange, whoever is holding the margin, is able to use that margin to protect themselves, right?

A. Correct.

Q. Of course when they use the margin to protect themselves any margin that's left over remains the property of the counterparty, right?

A. Yes.
Q. So if you're a broker-dealer and you post four billion dollars with an exchange and then you close out your position and the market has moved in your favor and there's no loss, you get your full four billion dollars back, right?
A. That's right.
Q. Now, if the market moves against you and you lose a bundle of money, like a billion dollars, then that billion dollars is gone, right?
A. Correct.
Q. And when your positions are closed out the exchange keeps that billion dollars, right?
A. No, it goes back to the clearing member.
Q. And the clearing member uses that billion dollars to protect itself.
A. Yes.
Q. But the clearing member can't keep the other three billion dollars, right?
A. You lost me.
Q. You had four billion dollars at the exchange. You lost one. The exchange closes you out but keeps the billion. The billion is gone. You never get that back, right?
A. Right.
Q. But you get the other three back.
A. You get the other three back, yes.

Q. The exchange can't keep the other three billion.

A. Correct.

Q. There's no rule of the exchange that allows the exchange to hold onto margin after it's fully protected itself.

A. Absolutely right.

Q. No rational participant in this exchange-traded derivatives market would think that margin could be used by an exchange to fatten its own profits or to go straight to its bottom line as opposed to simply covering itself against a downside risk.

A. Right.

Q. It's generally true, is it not, sir, that when market participants post margin, when they give margin to another market participant, they do so by way of posting it and giving the other participant, the exchange or the broker-dealer, a security interest in the margin, right?

A. Yes.

Q. They don't transfer the margin outright to the other side, right?

A. To the party carrying the exposure, no. They transfer a security interest to cover the party who has the potential risk that they won't perform and -- as you just described accurately.

Q. So if all Barclays needed was protection against all the downside risks that you've described: the market risk and the

clearing risk and so on, all it needed was a reserve or a security interest in margin; they didn't need an outright transfer of margin that it would keep even if it wasn't necessary.

A. That's incorrect.

Q. Sir, if the market moved in favor of all of the Lehman positions and none of the margin was necessary to protect Barclays, right? Right?

A. Is there a question?

Q. Are you with me so far?

A. Yes.

Q. You're saying Barclays got to keep all of the margin.

A. Look, this is why this -- this is why this is a -- this is why this area is complicated or you're making it complicated. There's a very simple concept. There are accounts. All of these positions are in an account. Clearing member has the responsibility to perform. Assets constitute a margin. The clearinghouse has a lien over those assets, and in order for an acquirer to acquire the positions in this case the OCC and the parties agreed that the interest in whatever margin was there would also go with the positions.

Now, it was very important to OCC because they didn't want to lose control over that margin. So they had a separate reason for wanting the transaction restructured the way it was. But Barclays, simply because it understood that the transaction

was that if they were going to take those risks they also wanted to take the only mitigant that they could, which was the margin in the account -- certainly the only mitigant at the time. It's possible that if the deal had closed as originally contemplated there would have been other mitigants like all the positions you described. That's also true.

Nevertheless, at the very least, even if all those positions had come over, Barclays would have still had the risk of an additional funding requirement because you don't know on day one exactly what the clearinghouse margin requirement is going to be and how much of what comes to you is in a form that can be transferred. As I discussed, the letters of credit could not be.

Q. So are you aware that Barclays considered asking Lehman for a security interest in margin?

A. It's -- I'm not aware that they did.

Q. Are you aware that Mr. Rosen considered asking for such a security interest?

A. I'm aware that there was a consideration that's obliquely referred to -- I don't recall Mr. Rosen's testimony on this point if he gave any -- but that with respect to the VIX positions that -- as I testified earlier, the record seems to reflect that that was a surprise to Barclays that that position was there and that Barclays was looking for additional protection over and above the amount of the collateral for that

position.

Now, in my view that was logical because the -- one of the ways that you would protect yourself against movements and volatility, which would be essentially reflective of moves in the market as a whole, and since the VIX underlier was the S&P, would be to have all the short positions in the futures contract. On the weekend they didn't have any futures contracts, they'd been blown out by the CME; those contracts trade at the CME. So there were no risk mitigants against that VIX position other than the margin. And given that you've got thirty percent of the open interest in the contract I would think it was completely logical for Barclays to consider and for Ed Rosen to disclose that 'Well, we're looking for more protection than what we're getting.'

Q. Can you please turn to tab 12 of your binder? And there you should see a sticker in the bottom right-hand corner of Movants' Trial Exhibit 736. Do you see that?

A. Yes, I do.

Q. And you'll see this is an e-mail that Mr. Rosen sent to a person at the SEC on September 20. You'll see there's an e-mail exchange back and forth there.

A. Yes.

Q. And in Mr. Rosen's e-mail, which is right in the middle of the page, he addresses this person at the SEC and he says, "Bob, tracked it down, just a junior associate and outside

counsel to the OCC that did not understand the conversation he was listening to. There are VIX futures positions in an account at OCC that are not part of the deal but that as a practical matter we may -- we have to take with the LBI OCC accounts. We see a lot of potential downside exposure in the position and we are trying to figure out how, away from OCC, we can protect B, such as with collateral or a reserve from Lehman to meet the potential liquidation exposure," then it goes on. So you see that in this e-mail Mr. Rosen was concerned about positions that were not part of the deal. You see that?
A. He described it was not part of the deal. I don't have any knowledge whether that was an accurate statement or not.
Q. And he's specifically concerned here, he's talking about the VIX positions at the OCC?
A. Yes.
Q. And he's concerned about downside exposure?
A. Yes, because as he describes it, whether they were, quote, "in the deal or not", by acquiring Lehman's obligations as a clearing member of the clearinghouse those contracts were not excluded from their exposure.
Q. Now what he's looking for is some way to protect B, which is obviously Barclays, right?
A. Correct, and I think he's very clear by the phrase "away from OCC" that he means more protection, as I described before, more protection when the margin was there, for the reasons I

described.

Q. And the protection he describes is a reserve or collateral, right?

A. Yes.

Q. And you understand that reserve or collateral means if the downside exposure comes to pass then the market participant takes the collateral or invades the reserve. But if there is no loss then they don't keep the collateral and it goes back to the person who posted it, right?

A. Theoretically yes.

Q. Now, do you know how Mr. Rosen figured this out?

A. No.

Q. You didn't discuss this with him?

A. No, I didn't. And by the way, I'm not sure I know what you mean by "figured it out", but --

Q. I think he referred to figuring something out. You don't know what ultimately happened with his consideration of seeking collateral or a reserve?

A. I don't know.

Q. Okay. Now, sir, if it were true that Barclays and Lehman agreed to transfer all margin to Barclays, you would expect the parties to have disclosed that to the Court and to the creditors and to the public, isn't that right?

A. I'm -- yes, we would expect that there would be a disclosure of the transaction and it would up to the parties to

determine whether or not any particular aspects of the transaction were relevant to be separately mentioned or disclosed.

Q. And the transfer of margin is not a difficult thing to disclose? Exchanges keep track of margin on a daily basis, is that right?

A. It's not difficult to disclose.

Q. Margin is not a difficult asset to value, right?

A. Correct.

Q. Exchanges keep very close track on exactly what cash and cash equivalents a market participant has in their account at the exchange at all points, isn't that right?

A. The exchange does, yes.

Q. Yeah. So if the parties decided that they needed to disclose the amount of margin that Lehman had that would not have been a difficult thing for them to disclose, isn't that right?

A. The exact amount of margin?

Q. Right.

A. It would in this case because I think there was testimony that Lehman's systems did not in fact have the information or at least have the information to supply to Barclays as to what the full quantity of margin at every potential venue where these positions were going to be assumed was. OCC, theoretically, might have been in and of itself easy but even

there what were you going to look at and when were you going to look at it? Were you going to look at it in the morning? Were you going to look at it at the close of business? Those were two different time frames. So if your question is what quantity would they disclose, I'm not sure that would have been in fact possible on that Friday.

Q. If there were a couple of billion dollars at the OCC it wouldn't have been terribly difficult to find that out?

A. Right, but there -- as I read the hearing record, there also wasn't a disclosure of the amount or value of the liabilities that were being assumed either. So there were aspects of this transaction that were described to the Court; the Court knows better than I what he was told. But the failure to talk about margin doesn't seem to me to be any more surprising that there was a failure to discuss the greater details of the equities division -- equities derivative business that was being transferred and the benefit, except in a very general way, to the estate of getting rid of that business and exposure.

Now, I think that Harvey Miller did talk about that either directly or obliquely, that Lehman was being able to transfer potentially billions of dollars of exposure. As I testified this morning, I didn't think it was possible to quantify what that risk and exposure was in view of the fact that in a liquidation context the losses could well exceed the margin

that was being posted.
Q. Not my question. My question is simply as to margin; not difficult to find out what the margin is at the OCC, correct?
A. If someone in this courtroom had called up the OCC and asked them what the margin was I don't think they -- it would have been that easy to find out. It took the parties a day to understand exactly what that margin was.
Q. Do you know that the OCC was here?
A. Yes, I believe there was a representative of the OCC here.
Q. If the OCC and Barclays and Lehman all say 'I just want to know how much cash there is in Lehman's account at the OCC,' if somebody did an e-mail or a call, the OCC would be able to look in the account, the margin account, and say exactly how much cash there was in that account, isn't that right?
A. I believe that's possible, yes.
Q. And as far as the other margin, the Treasury bills, the cash equivalents --
A. I --
Q. -- they could look in the account and see exactly what was in the margin account, isn't that right, sir?
A. I don't mean to sound equivocating here, but the problem with Friday was that among the other things that were happening to determine the amount of cash was that they drew down some letters of credit. So the composition -- we talked about the composition of the assets in the account, so they actually

changed during the day. So I'm not trying to be evasive but it depends on -- you know, if you called at 9 o'clock in the morning you would get one answer; if you called at 2 o'clock in the afternoon you would get a different answer. So would it have been possible to find out at a specific point in time? Certainly OCC would have told you what their records showed at that point in time but there would be different -- potentially different answers in the course of the day.

Q. But you would expect them to be responsive --

A. Yes.

Q. -- and to tell you the information they have?

A. Yes.

Q. And the same for Osaka or Tokyo or the Kansas City Board of Trade, any of the other exchanges that you listed in your report, they all keep track of the amount of cash and cash equivalents that the participant has left with them, isn't that right? Isn't that what an exchange has to do?

A. As I think the record shows and certainly what my report reflects is that a lot of the foreign positions were not held at clearinghouses or exchanges, they were held at foreign brokers. And at the time in question it's unlikely that they were open since it's already Saturday in the far east.

Q. If they hadn't gone to sleep or somebody had called them the day before, they'd have the number at their fingertips, right? Any market participant in this business, as you've told

us many times, needs to be able to act instantaneously; information they have to have at their fingertips --
A. Yes.
Q. -- isn't that right?
A. Yes.
Q. And that one of the most important pieces of information is how much cash and cash equivalents does this counterparty have with me right now, isn't that right?
A. Yes.
Q. And that whole week everybody was watching Lehman because everybody was worried about Lehman, isn't that right?
A. Yes.
Q. So every single counterparty, every single Lehman counterparty that had Lehman cash and Lehman cash equivalents, you believe knew exactly how much cash and exactly how much cash equivalents they had, isn't that right, sir?
A. Yes.
Q. Now, sir, if I could ask you to look at the -- I believe it's tab 16 of your binder. This is with respect to other separate contracts with the Options Clearing Corporation which you alluded to earlier in your testimony, the transfer and assumption agreement.
A. Yes.
Q. You see that this is Barclays's Exhibit number 286 and it's a transmitted e-mail from a Barclays -- from a Barclays'

outside lawyer to the OCC in which he says, "Sorry for the delay on this. The executed agreement is attached." And that is the transfer and assumption agreement. Do you see that, sir?

A. Yes.

Q. If you look, sir, at the attachment, and specifically to section 2, "Representations and Warranties", and if you look in there at section 2(c)(i).

A. Yes.

Q. I'm sorry, I misspoke -- 2(c). It says "Barclays hereby:" and little (i) goes "represents and warrants that it has received such documents and other information as it has deemed appropriate to make its own credit analysis and decision to enter into this agreement". Do you see that, sir?

A. Yes.

Q. Do you know who did that credit analysis?

A. No.

Q. Do you know what they did?

A. No.

Q. Do you know whether Barclays figured out over the weekend that it would get 2.3 billion dollars in cash and cash equivalents if it signed this contract?

A. I'm sorry, would you repeat the question?

Q. Do you know whether Barclays figured out over the Lehman weekend that it would get 2.3 billion dollars of Lehman cash

and cash and cash equivalents if it signed that contract?

A. It was certainly aware that it would get whatever was in the account. I'm not sure that they had all the records that indicated the exact amount or composition of what was in the account.

Q. So you don't know either way whether Barclays figured that out?

A. Whether they -- whether they precisely knew the number that they were getting.

Q. Do you know whether Barclays checked over the Lehman weekend and figured out that if they signed this contract they would be taking responsibility for certain affiliates' positions that could cost them 800 million dollars?

A. I don't believe they knew the amount but I think they knew that they were taking responsibility for affiliate positions.

Q. Do you know, one way or the other, whether Barclays did an analysis that basically amounted to subtracting 800 million dollars from 2.3 billion dollars and concluding that if it signed this contract it would get 1.5 billion dollars net in cash and cash equivalents.

A. No.

Q. All you know, sir, is that Barclays represented that it had received such documents and other information as it deemed appropriate to make its own credit analysis and decision to enter into this contract?

A. A standard rep and warranty, probably any deal lawyer who's seen this in any document that gets signed that has a similar purpose.

Q. And you would agree, sir, that Barclays somehow concluded that signing this contract was in its economic interest, notwithstanding all the risks that you -- the clearing risks that you described earlier?

A. Right.

Q. You mentioned something about the composition of margin, and I believe you told us generally it could be cash, it could be cash equivalents or it could be letters of credit, right?

A. Yeah, that's not the only assets that -- or transactions that constitute margin, but that was bulk -- the bulk of the cover in this account.

Q. And in this case there were in fact hundreds of millions of dollars of letters of credit, right?

A. Yes.

Q. And they had to be replaced?

A. Yes.

Q. And if those letters of credit had been in the billions of dollars they would have to have been replaced --

A. Correct

Q. -- as well? And replaced by Barclays.

A. Correct.

Q. If Lehman had all of its margin by way of letter of

credit, Barclays would have had to replace all of those letters of credit?

A. Yes.

Q. Now sir, I believe you referred earlier to your experience on the ad hoc committee for Reg T?

A. Yes.

Q. And when you said Reg T you're referring to a regulation, a federal law --

A. Yes.

Q. -- isn't that right? And that regulation is -- concerns banks and banking, and specifically credit by brokers and dealers, isn't that right?

A. Yes.

Q. And that is known popularly as Reg T?

A. Yes.

Q. That's a regulation that was promulgated for notice and comment, the industry had an opportunity to discuss and build a consensus on, and then it was adopted as a federal regulation.

A. I'm not sure that the process used by the Federal Reserve Board is exactly that, but certainly the rules of the securities regulatory associations that implement Regulation T under Section 7 of the Securities Exchange Act of 1934 would be published for comment.

Q. And you participated in the ad hoc committee in connection with that Reg T, right?

A. Yes.
Q. I'd like you to take a look at an excerpt from that regulation which deals specifically with definitions, and the definition I'm interested in is the definition of cash equivalent, do you see that?
A. Yes.
Q. So this is Reg T specifically credited by brokers and dealers. And the definition is "cash equivalent means securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, banker's acceptances issued by banking institutions in the United States and payable in the United States or money market mutual funds." And that's generally understood by market participants in the industry as cash equivalents, isn't that right, sir?
A. I wouldn't say that. I would say that the definition here is very specific to defining the types of assets that would be considered permissible for a broker-dealer to accept in margining equity securities under the regulation.
Q. And the reason for this is that cash can be held in the form simply of cash or you have these things called cash equivalents which are so liquid that they can be readily changed into cash, right?
A. Yes, although I'm aware of other contexts in which the definition of securities of the same type are more narrowly defined to apply only to securities whose maturity is within

six months. What the -- so this particular rule for this particular purpose is defining it more broadly. So my only quibble is with the fact that universally within the industry and for every purpose cash equivalent means that. It means that in this regulation for this purpose.

Q. And exchanges allow participants in the exchange-traded derivatives business to post margin in the form of cash equivalents instead of cash, isn't that right?

A. And in other forms. The -- I outlined in my report the types of collateral that are permissible. And in some cases corporate obligations and other obligations that are -- could be acceptable to the OCC. So they chose to use these particular instruments and it was much more common in practice to use them.

Q. So if the OCC tells me I have to put a billion of margin at the OCC I can put a billion dollars of cash at the OCC or I can go out and buy some T-bills, put them at the OCC, and get a tiny little bit of interest on my margin deposit, right?

A. Correct. But I can do other things, but that would be the common business practice, yes.

Q. Thank you, sir.

MR. MAGUIRE: I have no further questions.

THE COURT: Thank you.

Redirect?

MS. BLOOMER: Thank you, Your Honor.

REDIRECT EXAMINATION

BY MS. BLOOMER:

Q. Good afternoon, Mr. Leitner.

A. Good afternoon, Ms. Bloomer.

Q. Mr. Maguire asked you some questions about whether your opinions assumed that Barclays was in fact taking responsibility for all the positions in Lehman's exchange-traded derivatives accounts. Is it your understanding, based on your view of the evidence, that Barclays was in fact taking responsibility, settlement and clearance responsibility, for all of the exchange-traded derivatives positions in Lehman's account?

A. Yes.

Q. Mr. Maguire asked you about the facts on the ground on September 16th, at the time the APA was entered into. I'd like to consider some of those facts with you. On September 16th were the over-the-counter derivatives positions part of the transaction?

A. I don't believe they were.

Q. On September 16th were there exchange-traded derivatives positions in Lehman's accounts that were held on behalf of Lehman affiliates for which there were no related underlying securities in Lehman's equity portfolio?

A. Correct.

Q. At the time the parties entered into the APA on September

16th, was Lehman, the parent company, bankrupt?
A. Yes.
Q. Did you consider, when you formed your opinions in this case, whether it would have been rational for Barclays on September 16th, based on what it knew then, to take on LBI's exchange-traded derivatives positions, under the context of that deal that was being contemplated, without the margin?
A. It would not have been rational.
Q. Is it your opinion, as an expert in this industry who has studied the facts of this case, that a broker-dealer in Barclays' position would have been very concerned on Tuesday, September 16th, that the exchange-traded derivatives positions it was taking responsibility for contained negative exposures?
A. Yes.
Q. Was it possible, in your view, on September 16th, for Barclays to sort through LBI's trading book and its exchange-traded derivatives portfolio and identify the positions that bore no relation to the exchange-traded -- to the securities that Barclays was acquiring separate from the exchange-traded derivatives and to leave those exchange-traded derivatives positions behind in the deal?
A. No.
Q. Now, there were changes that occurred throughout the week that you discuss in your report, correct?
A. Yes.

Q. Did those changes make the prospect of taking over the exchange-traded derivatives even riskier than it otherwise would have been?
A. Yes.
Q. And is that what you were saying in your report in the sections that Mr. Maguire referred you to?
A. That's right.
Q. You were shown an e-mail in Mr. Maguire's binder -- and it's at tab 8 of that binder, Lehman's Exhibit 620.
A. Yes.
Q. And this was an e-mail -- two e-mails from Stephen King to Patrick Clackson. Do you know who Patrick Clackson is?
A. My understanding, he is a Barclays executive.
Q. And do you know what department Patrick Clackson worked in at Barclays?
A. I think -- I think he was in the finance division, what we would consider the treasury operation of my former firm.
Q. And Mr. King says in these e-mails to Patrick Clackson, "Why don't we add the initial margin on the repos -- sorry, I meant exchanges and clearinghouses." Do you know one way or the other whether Mr. King was suggesting that they add margin to the deal or whether they add margin to the draft acquisition balance sheet that they were working on putting together at that point?
A. I certainly can't tell from this document, and I don't

recall the -- Mr. King's testimony on this point.

Q. Mr. Maguire asked you some questions about Mr. McDade's testimony in this trial. Could you please pull up the April 27th official transcript, pages 45 to 46? And Mr. Maguire showed you testimony in which Mr. McDade suggested that he did not believe there was an intent to transfer margin for the exchange-traded derivatives, do you recall that?

A. Yes.

Q. If you could look at the lines that are up on the screen, lines 19 on page 45 through line 4 on page 46, Mr. McDade is asked:

"Q. You don't personally -- you were not personally involved in and you do not personally recall one way or the other what the deal was with respect to exchange-traded derivatives and their collateral."

Q. And he answers:

"A. To the specifics, yes, that's correct."

Q. And then he's asked:

"Q. And that's because you were not personally involved in those negotiations, correct?"

Q. And he says:

"A. That's correct."

Q. And then he's asked:

"Q. Who was involved in the negotiations with respect to exchange-traded derivatives and their collateral?"

Q. And his response, Mr. McDade's response:
"A. I don't have a specific answer or knowledge of that."
Q. Did you review that testimony in connection with your work on this case prior to today?
A. Yes, I did.
Q. And do you understand this testimony to mean that Mr. McDade was not involved in the discussions about the exchange-traded derivatives business and what the transfer of that business would entail?
A. That's the way I read it.
Q. Now, if you could turn -- if you could pull up the sale hearing transcript, BCI Exhibit 49A. And if you go to page 112 in that sale hearing transcript. This is at tab 13 in your binder if it's more convenient for you to follow along, but you can feel free to use the screen.
Mr. McDade here starts on page 112 at line 15 and this testimony goes over a couple of pages, and we'll show you those pages. Why don't we flip through them? This is a list -- first of all, the question that was put to Mr. McDade at the sale hearing was:
"Q. And I want to confirm some information given there. Pursuant to the proposed asset purchase agreement here, the businesses that are being -- the Lehman businesses being transferred to Barclays are as follows: Tell me if I'm incorrect, I'll read one at a time."

Q. And then he proceeds to read a list of businesses and this proceeds for another page and a half. Will you please look through that list and tell me whether you see businesses in that list that would include exchange-traded derivatives businesses?

A. Well, there are several references to derivatives which in the context of this transaction I would look at as -- would interpret as exchange-traded derivatives. On line 10, line 14, line 18.

Q. Then that would be cash equities, long and short proprietary trading --

A. Yeah, but going on to the next page I was -- first of all, on page 113 --

Q. Oh, I'm sorry.

A. -- then on page 114 --

Q. Um-hum.

A. -- the cash equities; convertible bonds -- options are often used to hedge convertible bonds; and long and short proprietary trading; options and futures --

Q. And --

A. -- customer options and futures.

Q. Thank you. And I'm sorry, on the prior page then, lines 10, 14, and 18, I believe, you suggested were --

A. And you could say 6 too, commodities, because in connection with commodities, you know, as I know from the J&M

(ph.) business futures are, you know, part of their commodities business.
Q. So taking -- based on your understanding of the businesses that Lehman was involved in, do you understand what McDade was telling the Court at the sale hearing that among the businesses being transferred were the exchange-traded derivatives businesses?
A. He was describing all these businesses in a very general high-level way.
Q. Now, the asset purchase agreement is at tab 21 of the binder that I gave you. If you can turn to page 6 --
A. Sorry, it's in the office; I only have their binder. But go ahead.
Q. Oh, I'm sorry. Actually, why don't we look at their binder; I believe it's in there. (Pause) Perhaps it's not. We have it up on the screen, sir.
A. Okay.
Q. I apologize for that. There's a definition of purchased assets but in that definition it says purchased assets means all of the assets of the seller and its subsidiaries used in connection with the business excluding the excluded assets. And then it has the word "including" which I represent to you is defined as including without limitation. And then they go on to list a number of specific assets.
A. Right.

Q. Now, this definition, "all of the assets of the seller and its subsidiaries used in connection with the business", does that include, in your opinion, based on your understanding in this industry, margin, assuming it's not an excluded asset?

A. Yes.

Q. And Mr. Maguire showed you Mr. Shapiro's testimony suggesting that Mr. McDade approved every aspect of this transaction. Do you believe, based on that testimony, that Mr. McDade approved this definition of purchased assets?

A. Yes.

Q. Now, Mr. Maguire asked you about whether Barclays could have gotten a list of the positions that it was taking on in this business prior to the closing. Did in fact Barclays obtain a list of those positions prior to the closing?

A. No.

Q. Did it at least obtain a list of certain positions before the closing?

A. Yes, it -- sorry, I think I testified before that it got, you know, sort of reams of position reports. So it did get, I think, on the Friday -- it got some information on Thursday, some information on Friday, but basically lists of collateral. It also got huge lists of the fixed income collateral that was included in the repo. So they were getting -- they were getting a lot of information, yes.

Q. First of all, were these lists complete, to your

understanding, in terms of showing the universe of all of Lehman's open exchange-traded derivatives positions including options and futures?

A. No.

Q. Okay. And second of all, for the ones as to which it was complete, could Barclays, based on what you understand under the circumstances of this deal, have determined the risk position of those positions based on the list that it was given?

A. No.

Q. And you saw earlier when we were talking during my direct examination and e-mail from Stephen King in which he said on the night of the closing that he was unable to determine the risk position four days into it, is that correct? Do you remember that?

A. Right.

Q. And he was suggesting in that e-mail, if you recall, that Lehman couldn't tell them what the risk position was either, is that right? Do you remember that testimony?

A. Yes.

Q. Was that significant to your conclusions?

A. Yes. And just to be clear, the positions they got that I recall looking at, of all the option positions, had one, you know, set of, you know -- very many pages of all the long positions and another set of very many pages of all the short

positions. But what they didn't do was to allocate them as to all the puts and all the calls, so you couldn't tell in the aggregate whether the short positions, which is really where the risk is, were more sensitive to the market going down or the market going up, which is what they were concerned about in terms of figuring out, you know, where the hedges were, again, because they had no S&P futures against that that might have mitigated some of the risk, so they were clueless.

Q. Mr. Maguire asked you some questions about whether the margin would all come back to Barclays if the market didn't move after the closing. Do you recall that line of questioning?

A. Yes.

Q. Okay. Let me ask you a specific question, a hypothetical question. If there was a billion dollars in margin that was required at the OCC on the day of the closing in the options accounts --

A. Right.

Q. -- and the market didn't move for the next month and then those options were exercised, would Barclays get back the billion dollars in margin or would that margin be used to settle the responsibility to perform the obligations that created that margin requirement?

A. Well, sorry, I can't answer that with a yes or no because the fact of the matter, it depends first of all on what

happens. And let's just divide these risks. I talked a little bit about them before. Over the weekend involved here there were settlement risks, so one of the things that would have affected the margin -- and in fact this is the practice of the OCC -- they would take into account all of these settlements and whether or not there was a net gain or loss in the account. And then they would either deduct from the account's cash what it was owed or they would add to the amount. These are called net pay settle. So there was that portion in -- actually in that document that shows that net pay collect. Now that happens every day because options can be settled every day. So number one, you have the risk that options will be exercised and they have to be covered. That would be the obligation of the clearing member to do that.

So your hypothetical, while it's a good one, really only applies in the case of a forced liquidation. So you know, it's up to the clearinghouse to figure out how to cover itself because it exercises its rights to do so and then it closes all the positions out and it uses whatever collateral is left. In the normal course, and what happened here was that Barclays attempted to manage the positions over time to mitigate the risk and possibly even, if lucky, make a profit.

Q. Now, Mr. Leitner, in your expert opinion, based on everything you know about this transaction, do you believe there was even a reasonable possibility that Barclays would

have agreed at any point during the week of September 15, 2008, to take over LBI's exchange-traded derivatives accounts if it believed it was not going to get the margin in those accounts?
A. No.
Q. And in your expert opinion, based on everything you know about this transaction, do you believe it was commercially reasonable for LBI to conclude that it was in the estate's best interest to transfer the entirety of those accounts to Barclays including the margin?
A. Absolutely.
Q. Thank you, sir.
MS. BLOOMER: No further questions, Your Honor.
MR. MAGUIRE: Nothing further, Your Honor.
THE COURT: You're excused. Thank you very much.
(Witness excused)
THE WITNESS: Thank you, Your Honor.
THE COURT: Is there anything more for today?
MR. SCHILLER: No, Your Honor, not on my part.
THE COURT: We're adjourned till tomorrow at 9:30. Professor Pfleiderer is coming in then, is that right?
MR. SCHILLER: Yes, Your Honor, he'll be here.
THE COURT: Fine. See you tomorrow.
(Whereupon these proceedings were concluded at 3:07 p.m.)

I N D E X

T E S T I M O N Y

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C E R T I F I C A T I O N

I, Clara Rubin, certify that the foregoing transcript is a true and accurate record of the proceedings.

Clara Rubin

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